

## CHAPTER I INTRODUCTION

### 1.1 Study Background

Economic reforms in Lao PDR started in 1986 when the New Economic Mechanism (NEM) was adopted and steps were taken towards a market-oriented economy. Under NEM, the Lao government promoted development of the private sectors, deregulating price and production controls. Since then, the Lao economy had attained steady growth under the prudent economic policies. However, after the Asian economic and financial crises in 1997, the Lao economy was deteriorated with high inflation and devaluation of the national currency and foreign direct investments (FDIs), which flourished in 1992-1996, have been stagnated.

The framework of development of the Greater Mekong Sub-region (GMS), on the other hand, was mapped out by ADB and six Mekong riparian countries. Located in the center of GMS, Lao PDR has been integrated into various development programs proposed for GMS. One of the spearheaded programs is the East-West corridor, connecting Da Nang in Vietnam and Mawlamyine in Myanmar via Savannakhet in Lao PDR. Cooperation among the GMS countries has been accelerated, particularly since Lao PDR joined ASEAN in 1997.

A concept for development of Special Economic Zones (SEZs) was brought forward by the Lao government for development of the border areas with China, Thailand, and Vietnam. The concept was, however, rather vague without clear definition on functions and roles of SEZs. Since Savannakhet province, located between Thailand and Vietnam, was designated as a priority area for SEZ development and since the government of Japan has been actively involved in construction finance for the East-West corridor via Savannakhet, the Lao government requested the government of Japan to study how SEZ can be developed in Savannakhet province.

In response to the request of the Lao government, the government of Japan decided to conduct a study on Special Economic Zone Development Plan in Border Area (Savannakhet province). In March 2000, JICA and SPC agreed on the Scope of Work for the Study and the JICA Study Team initiated the Study in July 2000.

## **1.2 Study Objectives**

The objectives of the Study are to formulate a development plan of SEZ in Savannakhet province. The development plan includes (i) policy and concept of SEZ as a trigger for economic development, (ii) institutional and legal framework building plan for development and management of SEZ, and (iii) preliminary physical plan.

To achieve the above objectives, the Scope of Work defines that the Study will cover the following items:

- 1) Analysis of potential and direction of economic/industrial promotion by developing SEZ in Savannakhet;
- 2) Formulation of a conceptual plan of SEZ in Savannakhet;
- 3) Formulation of a strengthening plan of administration and legal system for development and management of SEZ; and
- 4) Formulation of a physical development plan of SEZ.

## **1.3 Study Execution**

The Study Team started the field works in July 2000. The Inception Report was submitted by the Study Team and discussed with SPC at the outset of the Study. The Progress Report was also submitted and discussed in October 2000. The Study Team organized an international seminar in Vientiane to learn lessons from the SEZ operations in Asian countries, i.e. China, Korea, Thailand, the Philippines, and Vietnam. After the Draft Final Report was submitted in January 2001, discussions were made with the public and private organizations in Vientiane and Savannakhet. This Final Report has been compiled by incorporating the results of these discussions.

The Study Team has worked closely with the counterpart experts assigned by SPC. The Steering Committee has been organized and the Committee reviewed the reports submitted by the Study Team. A list of the Steering Committee members, SPC counterparts, and JICA Study Team is presented in the table in the following page.

## **1.4 Report**

The Final Report is composed of seven Chapters and four Appendices. In Chapter II, an overview of the Lao economy and industry is presented together with the rationale for SEZ development. The regional socio-economic background and regional opportunities/constraints are summarized in Chapter III. In Chapter IV,

trend of foreign direct investments (FDIs) is reviewed together with potential investment demands for SEZ in Savannakhet. The perspectives of SEZ in Lao PDR are discussed in Chapter V based on lessons learned from the Asian experience. In Chapter VI, the functions, location and physical plan of SEZ in Savannakhet are planned and proposed. In the last Chapter VII, legal and institutional frameworks for SEZ development are proposed.

**Table 1.1 Study Members**

Name	Position
<b>Steering Committee Members</b>	
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<b>JICA Study Team</b>	
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Mr. Yoichi Matsui	Sub-Leader, SEZ planner
Mr. Tetsuya Ishii	SEZ planner (organization/human resource)
Mr. Izumi Sakaya	Investment and Trade
Mr. Seiichi Aoki	Industrial planner
Mr. Teruo Matsuda	Land use planner
Mr. Masaru Tokura	Utilities planner

## CHAPTER II BACKGROUND: LAO ECONOMY AND INDUSTRY

### 2.1 Towards Market-Oriented Economy

#### (1) New Economic Mechanism

Lao People's Democratic Republic (Lao PDR) started economic reform called the "New Economic Mechanism (NEM)" in 1986, as major steps of a transition from a central-planned economy to a market oriented one. Under the NEM, the government promoted the private sector development by deregulating price controls and extending incentives to the private sector, while granting managerial and financial autonomy to state-owned enterprises. The following key reforms were implemented under the NEM<sup>1</sup>:

- 1) Price liberalization – Complete price liberalization except for some key utility prices;
- 2) Agricultural reform – Liberalization of agriculture, including introduction of cash payments to farmers for their production, and abolition of state monopoly over rice marketing;
- 3) Public enterprise reform – Increased autonomy for public enterprises, privatization of over 60 public enterprises;
- 4) Fiscal reform – Tax reforms to simplify and improve efficiency of the tax system, consolidation of central and provincial budgets into a single general budget;
- 5) Trade reform – Liberalization of internal and external trade, such as simplification of tariff codes and elimination of most quantitative restrictions and special licensing requirements;
- 6) Exchange rate reform – Unification of a multiple exchange rate system;
- 7) Banking and financial sector reform – Two-tier banking system set up and most aspects of banking activity open to private sector and foreign banks; and
- 8) Foreign investment policy reform – Liberal FDI code promulgated in 1988 with guarantees against nationalization, permission to repatriate capital and profits. More generous FDI Law passed in 1994.

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<sup>1</sup> This description is based on UNIDO 'A Comprehensive Framework to Foster Economic Initiative in Lao PDR', May 2000.

## (2) Current Economic Situation

In July 1997, Lao PDR gained a full membership of the Association of South-East Asian Nations (ASEAN), which required the country to follow a schedule of reduced import duty rates under the region's Common Effective Protection Tariff (CEPT), within a prescribed time frame. Lao PDR also announced that the country was going to join the World Trade Organization (WTO), apparently showing its intention to accelerate reforms for the transition to a market oriented economy.

Since the introduction of the NEM, the Lao PDR has attained steady economic growth with an annual GDP growth rate of 6 to 8% under prudent economic policies. A market economy has been gradually introduced through implementation of various economic reforms mentioned above. However, the onslaught of the Asian financial and economic crisis and the introduction of relaxed monetary and fiscal policies in 1997, caused the deterioration of economic conditions and slowed structural reforms. The recent sharp depreciation of the Lao currency Kip against the US dollar caused high inflation in 1998 and 1999, though in 2000 the exchange rate has been stabilized thanks to a tighter monetary policy (see Table 2.1).

**Table 2.1 Key Economic Indicators**

	1994	1995	1996	1997	1998	1999
Real GDP Growth (%)	8.1	7.1	6.9	6.9	4.0	7.3
CPI Change (%)	6.8	19.6	13.0	27.5	91.0	144.6
Budget Balance (% of GDP)	0.4	1.4	2.8	1.8	3.0	na
Current Account Balance (% of GDP)	-17.1	-11.5	-16.4	-16.1	-10.0	-9.9
Debt Service Ratio (%)	3.3	5.7	5.3	8.9	8.4	na
Exchange Rate (Kip per US\$)	719.0	925.0	954.0	2135.0	4274.0	7059.0
GDP Share by Industrial Origin (%)	100.0	100.0	100.0	100.0	100.0	100.0
Agriculture	57.6	55.7	53.3	53.3	52.6	52.0
Crops	29.0	26.5	25.1	27.1	27.5	27.7
Livestock and fishery	22.6	22.0	21.4	20.1	19.6	18.7
Forestry	6.0	7.2	6.9	6.1	5.5	5.5
Industry	18.1	19.2	21.1	21.2	22.0	22.0
Mining	0.2	0.2	0.3	0.4	0.4	0.4
Manufacturing	12.9	14.3	15.9	16.0	16.7	16.9
Construction	3.4	3.4	3.5	3.5	2.7	2.7
Electricity, gas and water	1.6	1.4	1.5	1.3	2.1	2.0
Services	24.3	25.1	25.5	25.5	25.4	25.2
Transport and communication	4.8	5.4	5.8	5.7	5.8	5.7
Trade	8.3	8.5	8.7	9.1	10.4	10.4
Others	11.2	11.3	11.0	10.7	9.2	9.1

Sources: IMF, 'Recent Economic Developments January 2000', EIU, and NSC.

The neighboring countries, especially Thailand and Vietnam, have shown faster-than-expected recovery from the crisis. However, having the disadvantage of being a land locked territory prevents Lao PDR from achieving rapid development driven by external economic relations. Further,

with a small population, the country does not have a sufficient workforce, which Thailand and Vietnam have, nor does it have an accumulation of capital or advantages in technology. All these factors cause Lao PDR to still be heavily dependent on foreign aid.

At the moment, the Lao government is trying to stabilize its macro-economy with assistance from foreign countries. In the mid term, the most important factors in revitalizing the Lao economy may be: i) to promote foreign direct investment which contributes to export increase and brings about technology transfer; ii) to strengthen local industries with prudent privatization, and iii) to develop human resources which is indispensable in supporting such economic reforms.

### (3) Public Finance and Monetary Sector

The fiscal balance of Lao PDR has been constantly deficit-ridden while the deficit is financed by ODA loan and grants (Table 2.2). In fiscal year 1998/99, tax revenue increased significantly, even after taking account of inflation, due to the strengthening of tax administration by setting targets for small and medium business establishments to be consistent with new tax rate. Since fiscal year 1997/98, the proportion of capital expenditure has significantly increased because of the increasing number of infrastructure construction projects financed by ODA. The overall budget deficit (excluding grant) for the year 1998/99 stood at approximately 9% of GDP.

**Table 2.2 Government Budget**

Unit: Billion Kip

	1995/96	1996/97	1997/98	1998/99*
Revenue and Grants	274.9	298.2	557.0	1,461.5
Revenue	217.3	228.3	367.0	929.2
Tax	175.9	189.6	290.0	745.4
Non-tax	41.4	38.7	77.0	183.7
Grants	57.6	69.9	200.0	532.3
Expenditure	364.4	412.2	864.6	1,719.0
Current	166.0	192.2	267.5	449.3
Capital and on-lending	198.4	220.0	579.0	1,269.6
Overall Balance	-89.5	-114.0	-279.8	-250.1
Excluding grants	-147.1	-184.0	-479.6	-782.5
Financing	89.5	114.0	279.8	250.1
Domestic	-19.6	-0.5	56.6	-143.1
Net foreign financing	109.1	113.5	223.2	393.3

Note: Estimated for the year 1998/99

Source: Bank of the Lao PDR, 'Annual Report 1999'

Since 1997, the money supply has grown significantly causing high inflation. The Bank of Lao PDR has adopted tight monetary policies by selling treasury bills and Central Bank bills and succeeded in containing inflation (Table 2.3). The ratio of the money supply to nominal GDP, which stands at around 18% of nominal GDP at the end of 1999, gradually increased in the 1990s, indicating development of the financial sector of Lao PDR. However, to promote domestic savings, it is crucial to further improve the credibility of the banking system, as well as maintain stability, consistency and transparency of economic policy as a whole.

**Table 2.3 Monetary Survey**

Unit: Billion Kip

	1997	1998	1999 (est.)
Net Foreign Assets	250.4	498.2	1,271.0
Net Domestic Assets	155.6	367.8	274.3
Liquidity (M2)	406.0	865.9	1,545.4
GDP at Current Prices	2,200.7	3,745.0	8,700.0
M2/GDP at Current Prices (%)	18.4	23.1	17.8

Note: Figures as of December each year

Source: Bank of Lao PDR, 'Annual Report 1999'

#### (4) Progress of Transition to Market Economy

As mentioned above, in Lao PDR, the transition of the economy from a central-planned to market-oriented system, with the introduction of NEM, has achieved relative macro-economic stability more quickly than in other economies, although since 1997 the pace of reforms has slowed down mainly because of the East Asian economic crisis.

However, it is crucial for Lao PDR to further consolidate consistent stabilization measures and renew the reform effort to strengthen the economy. Structural reforms are needed particularly in the regulatory environment for the private sector, and in the financial sector.

##### 1) Reforms for Private Sector Development

There are occasional restrictions on the imports of the inputs, general difficulties with importing and exporting materials, and bureaucratic red tape, which hinder the development of private sector activities. Those restrictions have to be removed in practice.

The institutional framework will need to be strengthened to attract high levels of FDI. The regulatory environment often lacks transparency and contains many informal practices that increase the cost of doing business.



Since the beginning of economic reform, approximately 90% of state-owned enterprises (SOE) have been converted to another system of management or have been liquidated. The government still sets production targets and controls the price on certain goods.

## 2) Financial Sector Reforms

The financial sector is a major obstacle to economic recovery and macroeconomic stability. Central Bank supervision is weak and commercial banking capacity is not good enough. While a series of reforms have been practiced, including the merger of the seven state-owned commercial banks (SOCB) into three, further changes are critically needed in such areas as corporate governance of SOCBs; reduction of government interventions; and upgrading of accounting standards and supervision capacity of the Central Bank. It should be also noted that substantial share of the non-performing loans arises from SOEs.

## 2.2 Industrial Sector

### (1) Overview

The industrial sector comprises mining, manufacturing, construction and electricity. Of total GDP, the sector accounts for 22.0% in 1998, which has gradually increased its share from 18.1% in 1994.

While agriculture is the predominantly important economic sector of the country, accounting for more than half of GDP and 80% of total workforce, the industrial sector has been the leading growth sector which enjoyed the double digit growth in 1993-1996.

**Table 2.4 Growth of GDP by Industrial Origin**

	1994	1995	1996	1997	1998
Total GDP	8.1	7.0	6.8	6.9	3.9
Agriculture	8.3	3.1	2.3	7.0	3.7
Industry	10.7	13.1	17.0	8.1	8.5
Mining	30.4	-3.7	37.1	28.5	13.7
Manufacturing	7.0	17.7	18.9	9.3	9.6
Construction	17.2	6.8	8.7	5.0	-18.2
Electricity, gas and water	29.0	-8.8	15.0	-1.9	62.7
Services	5.5	10.2	8.7	7.5	4.8

Source: IMF, 'Recent Economic Developments January 2000'

Table 2.5 shows key indicators of the industrial sector in 1999, estimated by UNIDO. As for the number of establishments which have 10 or more employees, non-metallic mineral products, wood and wood products, and

food and beverage are three major industrial-subsectors, while the wearing apparel subsector has by far the largest number of persons engaged, with 15,200 persons or nearly half of total manufacturing employees. The wearing apparel subsector also produces the largest manufacturing output around a third of the total; however, the food and beverages subsector contributed more than the wearing apparel to the manufacturing sector, in terms of value added as the former has higher value added ratio. Nevertheless, it is apparent that labor-intensive subsectors are dominant in the Lao manufacturing sector.

It is a salient feature that in the industry sector, electricity supply has such an important role that, combined together with water supply, it produces 42% of total industry value added although the number of employees are less than 10%, with highest labor productivity of 95,400 kips per person.

**Table 2.5 Key Indicators of Industrial Sector in 1999**

ISIC	Number of Establishment	Number of Persons Engaged	Gross Output	Value Added	Value Added per Person	Value Added Ratio
	Numbers		Kips million		Kips '000	
Mining and quarrying	14	715	33,471	14,960	20,923	0.45
Manufacturing	410	32,677	1,243,517	468,273	14,330	0.38
15 Food & beverages	74	2,276	233,439	157,860	69,359	0.68
16 Tobacco products	8	853	74,670	56,030	65,686	0.75
17 Textiles	5	375	4,836	275	733	0.06
18 Wearing Apparel	44	15,227	411,566	100,112	6,575	0.24
20 Wood & wood products	79	6,819	189,024	17,187	2,520	0.09
21 Paper & paper products	5	311	5,438	299	961	0.05
22 Publishing & printing	8	386	11,705	4,658	12,067	0.40
24 Chemical & chemical products	23	732	31,755	12,739	17,403	0.40
25 Rubber & plastic products	11	536	24,849	7,267	13,558	0.29
26 Non-metallic mineral products	97	2,473	58,355	36,089	14,593	0.62
27 Basic metals	4	583	23,875	12,376	21,228	0.52
28 Fabricated metal products	9	257	43,515	14,675	57,101	0.34
29 Machinery & equipment	7	218	9,342	2,355	10,803	0.25
31 Electrical machinery	2	104	6,108	696	6,692	0.11
34 Motor vehicles	9	864	69,990	22,750	26,331	0.33
35 Other transport equipment	4	181	32,226	12,537	69,265	0.39
19,30,33,36 Other manufacturing	21	482	12,824	7,885	16,359	0.61
Electricity and water supply	3	3,683	920,678	351,354	95,399	0.38
Industry Total	427	37,075	2,197,666	834,587	22,511	0.38

Notes: ISIC stands for International Standard for Industrial Classification.

Numbers for establishments with 10 and more persons engaged.

Sources: UNIDO, 'Survey of Industrial Establishments, 1999'

Seen in Table 2.6 is output of selected major manufacturing goods, which indicates steadily increased industrial production with some fluctuation in recent years. Although reliability of statistics is not fully confirmed, the manufacturing sector has been no doubt the leading sector of the whole economy.

**Table 2.6 Output of Major Manufacturing**

	Unit	1994	1995	1996	1997	1998
Hydropower	million kwh	1,197	1,085	1,248	1,219	1,996
Beer	'000 hectliter	102	151	240	286	332
Detergent	tons	700	877	913	870	912
Nails	tons	56	61	544	750	624
Electric cord	'000 m	1,798	2,192	2,441	3,100	2,250
Wood furniture	million kip	6,500	6,622	7,210	7,800	7,155
Garments	million pieces	11	18	19	21	23
Cement	'000 tons	7	59	78	84	-

Source: IMF, 'Recent Economic Developments January 2000'

It is a challenging task to set a scenario of future industrial development of Lao PDR because the country, with limited resources, might face difficulty in following suit of the patterns of industrial development of other ASEAN countries which started with labor-intensive manufacturing in the initial stage of the industrialization and then gradually upgraded their industrial structure through capital accumulation and improvement in technology.

## (2) Size and Provincial Distribution of Industry

There are over 20,000 industrial establishments registered under the Ministry of Industry and Handicraft in 1999, as seen in Table 2.7. It should be noted that small scale industries with less than 10 employees account for 97% of the total, while only 108 establishments, or 0.5%, have 100 or more employees, and 494, or 2.5%, have 10 to 99 employees.

Large scale industries concentrate in a few provinces, namely, Vientiane Municipality, and Khammouan and Savannakhet provinces. They are located intensively in Vientiane Municipality in particular, with 64 establishments, or 59% of the total, concentrated there. On the other hand, small scale industries are generally dispersed all over the country, but Luangphabang and Savannakhet provinces have more small establishments than other provinces.

**Table 2.7 Provincial Distributiou of Industry Registered  
under Ministry of Industry and Handicraft in 1999**

Province	Size of Establishment						Total	
	Large		Middle		Small			
Vientiane Municipality	64	59%	140	28%	1,045	5%	1,249	6%
Phongsaly	0	0%	2	0%	1,189	6%	1,191	6%
Luangnamtha	1	1%	7	1%	422	2%	430	2%
Oudomxay	0	0%	11	2%	1,292	7%	1,303	6%
Bokeo	0	0%	21	4%	493	2%	514	3%
Luangprabang	0	0%	7	1%	2,347	12%	2,354	12%
Huaphanh	0	0%	3	1%	235	1%	238	1%
Xayabury	0	0%	34	7%	1,020	5%	1,054	5%
Xiengkhuang	0	0%	11	2%	883	4%	894	4%
Vientiane	4	4%	48	10%	1,759	9%	1,811	9%
Borikhamxay	7	6%	31	6%	1,531	8%	1,569	8%
Khammouan	18	17%	11	2%	1,671	8%	1,700	8%
Savannakhet	8	7%	69	14%	1,943	10%	2,020	10%
Saravane	0	0%	18	4%	1,396	7%	1,414	7%
Sekong	0	0%	16	3%	341	2%	357	2%
Champasack	6	6%	53	11%	1,853	9%	1,912	9%
Attapeu	0	0%	8	2%	240	1%	248	1%
Xaysombourn	0	0%	4	1%	137	1%	141	1%
<b>Total</b>	<b>108</b>	<b>100%</b>	<b>494</b>	<b>100%</b>	<b>19,797</b>	<b>100%</b>	<b>20,399</b>	<b>100%</b>

Note: Small: 9 or less employees, Middle: 10 to 99 employees, Large: 100 or more employees

Source: 1975-2000 Basic Statistics of Lao PDR

### (3) Industrial Development Plan

In March 2000, The Ministry of Industry and Handicraft prepared ‘Industrial and Handicraft Development Plan for the Year 2001-2005’. In the Plan, the industry sector is expected to play a major role for economic growth and promotion of the industry is encouraged for the purpose of both import substitution and export promotion. The following targets are set out to be achieved in the planned period:

- Annual growth rate of industry from 2001 to 2005 - 10.2%,
- GDP share of industry in 2005 - 27%,
- Total industry export value in 2005 - 400 million dollars.

## 2.3 Trade and Investment

### (1) International Trade

Lao PDR suffers chronically from a trade deficit, as the total imports often reach as much as double the total exports. Further, it is believed that there are a lot of informal trade, though no estimate of its magnitude is available.

The main export earners of Lao PDR are wood products, garments, electricity, coffee and motorcycle. Of these, timber and coffee have shown significant increase in recent years. On the other hand, Lao PDR imports a wide variety of goods ranging from capital goods to consumer goods.

Including construction/electrical equipment, materials for garments, fuel and machinery and equipment (Tables 2.8 and 2.9).

**Table 2.8 Composition of Imports**

	(Million US\$)				
	1994	1995	1996	1997	1998
Total Imports	564.1	588.8	689.6	647.9	552.8
Investment goods	146.1	189.3	277.0	226.8	226.7
Machinery and equipment	32.0	43.8	71.3	52.0	44.4
Vehicles	25.0	36.0	71.7	53.8	39.4
Fuel	21.4	30.8	32.8	38.2	61.8
Construction/electrical eqpmt	67.7	78.8	101.2	82.8	81.1
Consumption goods	276.5	282.8	308.0	267.7	234.1
Materials for garments	51.3	66.3	70.0	73.7	66.8
Motorcycle parts for assembly	34.6	13.3	12.0	24.9	17.0
Gold and silver	46.8	29.5	18.8	50.4	0.7
Electricity	2.4	3.1	2.6	3.2	5.8

**Table 2.9 Composition of Exports**

	(Million US\$)				
	1994	1995	1996	1997	1998
Total Exports	300.4	313.3	321.4	316.9	336.7
Wood Products	96.1	88.3	124.6	89.7	115.4
Logs	41.8	28.7	34.3	16.7	10.5
Timber	48.5	51.5	78.7	67.4	87.4
Coffee	3.1	21.3	25.0	19.2	48.0
Garments	58.2	76.7	64.1	90.5	70.2
Motorcycle	46.2	17.7	12.5	17.1	17.8
Electricity	24.8	24.2	29.7	20.8	60.7

Main destinations of the Lao exports are Vietnam and Thailand, which accounted for 42.7% and 22.1% of the total exports in 1997, respectively. The heavy concentration of exports to these two countries puts the country in a vulnerable position. Main source of imports, on the other hand, is Thailand which accounts for almost half the total imports (Table 2.10). Although the official import figures are available in Lao PDR only up to 1997, the share of imports from Vietnam is a mere 4%. A Vietnamese figure in 1999 indicates exports from Vietnam to Lao PDR amounted to US\$175 million, or equivalent to 25% of total imports of Lao PDR. At any rate, Thailand and Vietnam have been by far the most dominant trade partners of Lao PDR.

Detailed and comprehensive statistics on Laotian imports and exports with Thailand and Vietnam are not available. However, it is reasonably presumed<sup>2</sup> that main export products from Lao PDR to Vietnam are wood and wood

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<sup>2</sup> The presumption is based on unofficial raw data provided by the Ministry of Commerce and Tourism, Lao PDR.

products, coffee and other agricultural products, fat products, and mineral products, while main imports from Vietnam to Lao PDR are construction equipment, food, and clothing and utensil. Likewise, main exports from Lao PDR to Thailand are wood and wood products, mineral products and agricultural products while main imports from Thailand to Lao PDR comprise construction equipment, agricultural equipment, and food.

**Table 2.10 Direction of Trade**

(%)

Exports in Percentage				
	1994	1995	1996	1997
Thailand	25.7	26.6	30.2	22.1
Vietnam	27.0	28.0	49.1	42.7
France	3.4	3.5	2.6	6.3
United Kingdom	0.3	0.3	2.1	4.7
USA	1.7	1.7	0.8	2.2
Germany	3.9	4.1	1.5	5.1
Japan	1.6	1.7	0.5	2.1
Belgium	0.4	0.4	0.6	5.6
Other	36.0	33.7	12.6	9.2
Total	100.0	100.0	100.0	100.0
Imports in Percentage				
	1994	1995	1996	1997
Thailand	47.9	48.9	45.0	51.9
Japan	8.1	8.3	7.6	1.6
Vietnam	4.0	4.1	3.7	3.9
Singapore	2.6	2.7	2.5	0.1
China	3.6	3.7	3.4	0.8
Taiwan	0.8	0.8	0.8	0.7
Hongkong	1.2	1.3	1.2	1.5
Korea	0.4	0.4	0.4	0.5
Other	31.4	29.8	35.4	39.0
Total	100.0	100.0	100.0	100.0

Source: Ministry of Commerce and Tourism

## (2) Foreign Direct Investment

### 1) Foreign Investment Policy

It is an official policy to promote foreign direct investment (FDI) as means of boosting development and economic growth. Foreign Investment Law of 1994 is open and liberal, as some examples show:

- Foreign investment is only specifically prohibited in sectors affecting national security, or in areas deemed detrimental to the environment or public health;
- A hundred percent foreign ownership in all sectors, except hydropower and mining, is permitted;

- Profits are taxed at a flat 20% rate, and expatriate staff incomes at 10%;
- Materials and equipment imported for use of the investor enjoy only 1 percent import duty;

However, the effectiveness of Foreign Investment Law is undermined by the inconsistency of its application. The decline in FDI since 1996, while partly due to the regional economic crisis, is rooted in other factors, such as:

- Other laws, such as Business Law, Mining, and Electricity Laws barring foreign investment in practice;
- Government decrees and ad hoc administrative orders sometimes contradict with the principle of Foreign Investment Promotion Law;
- Bureaucratic impediments to the application process;
- A lack of transparency in the regulatory framework (e.g., intervention of administrative regulations in manufacturing and services activities); and
- An uncertain domestic economic environment.

It is expected that the efforts to become a member of WTO may help promote greater transparency and consistency in the legal and regulatory frameworks .

## 2) FDI Statistics

Since 1988 up to mid 1999, FDI from 35 countries registered over 750 projects, with total value of over US\$7 billion. The number of approved projects increased rapidly from less than 40 per year in 1988-90 to more than 100 per year in 1994-96. However, since 1997 the number of approved projects has dropped as seen in Table 2.11.

Since 1994 more than 85% of FDI value have come from the Asian countries. Thailand is the largest investor in Lao PDR with 37% of the total value of approved FDI, followed by USA, Malaysia, South Korea, and France.

Sector-wise, the hydropower is the leading sector to attract FDI in value terms, (US\$4.5 billion) accounting for almost two-thirds of the total approvals. Manufacturing, such as wood processing and textiles, and tourism account for 10% of the total (see Table 2.12).

**Table 2.11 Foreign Direct Investment (Approval) by Country (in million US\$)**

		1994	1995	1996	1997	1998	1999*
Thailand	Number	54	21	17	15	15	7
	Value	2,013.0	35.2	761.5	9.5	65.6	4.7
USA	Number	8	2	4	4	2	5
	Value	4.9	0.1	6.7	0.9	1.2	0.9
Taiwan	Number	6	1	1	2	3	1
	Value	8.2	6.7	0.5	0.3	1.3	0.1
France	Number	11	6	8	5	11	4
	Value	3.0	1.5	1.0	1.0	2.3	0.4
Malaysia	Number	1	2	2	5	2	1
	Value	3.4	5.1	211.2	73.2	3.0	11.4
United Kingdom	Number	1	1	3	1	2	1
	Value	3.5	4.0	17.9	0.2	0.3	41.7
Australia	Number	7	6	0	6	3	0
	Value	7.1	1.7	0.0	5.6	1.5	0.0
South Korea	Number	5	2	6	3	5	5
	Value	2.8	277.4	276.8	6.9	6.6	3.8
Singapore	Number	1	1	1	3	2	1
	Value	0.5	0.2	10.0	2.2	0.4	1.0
Japan	Number	5	5	4	8	5	1
	Value	1.0	5.2	2.8	4.3	2.0	0.7
Germany	Number	4	0	0	1	1	0
	Value	1.5	0.0	0.0	0.1	0.4	0.0
Canada	Number	1	1	0	1	1	1
	Value	0.1	0.3	0.0	0.2	0.7	0.0
Other	Number	14	6	11	15	10	12
	Value	6.5	15.7	1.1	5.8	30.7	8.3
Total	Number	131	63	63	72	68	43
	Value	2,064.3	366.3	1,292.6	113.8	122.5	78.4

Notes: First 10 months for 1999

Total investments value differs from the sector table because the country table excludes domestic portion of FDI.

Source: IMF 'Recent Economic Developments January 2000'

**Table 2.12 Foreign Direct Investment (Approval) by Sector**

(Million US\$)

		1994	1995	1996	1997	1998	1999*
Agriculture	Number	7	3	6	11	8	8
	Value	6.8	5.1	1.9	6.3	7.9	62.0
Garments/Textile	Number	8	6	4	4	7	2
	Value	12.3	13.1	2.7	2.6	5.0	0.9
Wood-based Industries	Number	5	1	2	2	1	0
	Value	22.4	0.6	12.0	2.1	2.5	0.0
Other manufacturing	Number	20	9	14	13		5
	Value	18.0	46.0	320.1	13.4		4.9
Mining/petroleum	Number	3	9	0	2	3	2
	Value	9.6	27.1	0.0	14.0	8.3	4.7
Trade	Number	16	4	11	8	5	6
	Value	8.9	0.4	7.9	5.0	1.0	2.6
Hotels/tourism	Number	6	1	3	2	4	0
	Value	279.3	0.3	211.7	0.5	1.8	0.0
Electric power	Number	3	1	1	0	0	0
	Value	2,146.0	498.4	231.8	0.0	0.0	0.0
Other	Number	62	21	22	24	30	20
	Value	30.1	24.0	504.4	18.5	96.0	19.0
Total investments	Number	130	55	63	66	68	43
	Value	2,598.3	615.0	1,292.6	142.4	122.5	94.0

Note: First 10 months for 1999

Source: IMF 'Recent Economic Developments' January 2000

The FDI promotion policies, especially concerning which industrial sub-sectors are to be promoted with priority, should be closely related to the industrial development policy itself.



## 2.4 Economic Development Plans

### (1) Mid-Term Prospects

Apart from NEM, the Lao government has implemented four five-year development plans so far. At present the '1996-2000 Social-Economic Development Plan' is about to be concluded without achieving one of its goals, per capita GDP of 500 US\$. The next five-year plan up to the year 2005 is being prepared by the State Planning Committee and its outline is yet to become available.

On the other hand, IMF prepared 'Framework for the Outlook of the Economy to Year 2004' in May 1997 (Table 2.13). According to the report, the IMF envisages annual GDP growth of 6.5% in the years from 2001 to 2004, based on an assumption that Lao PDR continues high investment rate of more than 26% and increase its domestic saving rate to more than 20% after 2001. Judging from current domestic saving rate of less than 15%, reality of the scenario depends on how the government can mobilize domestic saving if Lao PDR seeks to decrease its dependency on foreign savings.

**Table 2.13 Economic Projections to the Year 2004 (IMF)**

	1996	1998	2000	2002	2004
Real GDP Growth (%)	6.8	7.0	7.0	6.5	6.5
CPI Change (%)	13.0	4.5	4.0	4.0	4.0
Fiscal Balance excluding Aid (% of GDP)	-5.6	-3.5	-2.0	-2.0	-1.8
National Savings (% of GDP)	14.0	14.5	17.2	20.2	21.1
Private Sector	10.7	9.9	10.8	13.1	13.3
Public Sector	3.3	4.6	4.3	2.4	1.9
Domestic Investments (% of GDP)	30.5	28.9	28.3	27.3	26.4
Private Sector	19.5	18.5	18.0	17.2	16.3
Public Sector	11.0	10.4	10.3	10.1	10.1

Note: Projections were made in 1997.

Sources: OECF 'The Lao Economy: Its Current Status and Future Challenges', 1999.

### (2) Vision 2020

Besides the new Social-Economic Development Plan, SPC is currently preparing a long-term development plan, called the "Vision 2020". The Vision 2020 will set out targets in order to graduate from the ranks of the Least Developed Countries (LDC) by the year 2020, by adopting three basic policies; (i) to attain sustainability of the Lao economy through a middle-range growth rate (7-8% per annum), (ii) to attain balanced

development by minimizing gaps in the society, and (iii) to protect environment in socio-economic development.

The national priority programs will be defined under the Vision 2020, which will include the following:

- (i) Food production and self-sufficiency,
- (ii) Commercialization of products, including improvement for access to markets,
- (iii) Abolition of shifting cultivation,
- (iv) Development of the rural areas, including introduction of rural pilot development programs,
- (v) Development of infrastructure, including rural road improvement,
- (vi) Human resources development,
- (vii) Development of the service sector, including tourism and information technology services, and
- (viii) Development in the framework of international cooperation (e.g., ASEAN, WTO).

## **2.5 Highlights of Lao Economy and Rationale for SEZ Development**

### **(1) Highlights**

The position and trend of the Lao economy and industries can be characterized as summarized below:

#### Macro economy

- The economy has been relatively stable with annual GDP growth of 6 to 8% after the initiation of economic reforms in 1986, though since 1997 when Asian economic crisis started, the Lao economy has faced difficulties including high inflation.
- Agriculture is the predominantly important economic sector of the country, accounting for more than half of GDP and 80% of total workforce. However, prospects of the Lao economy towards 2005 and 2010 depend on how the industrial sector will be boosted and contribute as an engine for economic growth.
- External account is structurally deficit-ridden, as current account deficit is financed by foreign capital inflow of ODA and FDI. Promotion of FDI

is particularly important to further finance the country's investment-savings gap.

- Financial and banking system is still immature, which is one of the causes of the low domestic savings rate. Further improvements are required to enhance financial and banking sector.
- There still remains a lack of transparency in the regulatory framework under the transitional period to the market economy.

#### Industry

- The manufacturing sector, though not significant in terms of the GDP share, has been and will continue to be the leading sector of the economy.
- Because of a number of constraints including small population, limited capital accumulation and insufficient technology, the level of industrial development still remains in the immature stage, keeping labor-intensive or resource-based industries as main manufacturing sub-sectors. Even under such situations, the Lao industries are required to enhance international competitiveness.
- Of the country's 20,000 enterprises, 97% are small industries with 9 or less employees. Particular attention is required to promote SMEs.
- Large scale industries, though small in number, are concentrated in Vientiane, Khammouan and Savannakhet provinces. Necessity of appropriate industrial location (e.g., resources, urban centers transportation and other infrastructure) should be duly taken into account.

#### Trade and investment

- Total imports always exceed total exports, leaving the country in a huge trade deficit. Export promotion is indispensable to improve balance of payment.
- Main export goods are wood products, garments, electricity, coffee and motorcycles, while imports consist of wide variety of items including consumer goods, capital goods and raw materials. Due to the small size of domestic market, there is a limitation in promoting the import-substitution type of industries.
- Thailand and Vietnam, two neighbors, are by far the most dominant trade partners. These relations will continue under the AFTA free trade regime.

- The number and value of FDI to the country increased rapidly from the late 1980s to the mid 1990s, but sharply dropped after Asian economic crisis. Some specific measures should be taken to revitalize FDI.
- The largest investor in Lao PDR is Thailand, followed by USA. Most of FDI has been made by Asian countries for the last 5 years. FDI should be promoted with due consideration for competitiveness under the AFTA regime.

## (2) Rationale for SEZ Development

Judging from review of the Lao economy and industries, it can be concluded that development of the Special Economic Zone (SEZ) will be one of the most effective strategies that the Lao government can adopt for promotion of FDI. Moreover, the development of SEZ may also accelerate the country's transition to the market-oriented economy.

It is obvious that a developing country with limited government budget like Lao PDR, must strategically allocate its resources intensively in the specifically designated area, when it tries to promote foreign investment in the country. By providing infrastructure, facilities, services and special incentives with international standards, which have not been available outside the zone, the country can take a competent position in attracting FDI.

In the last couple of decades in East and South-East Asian countries, the development of various types of special economic zones has played a vital role in promoting FDI to host countries, contributing much to their rapid economic growth. The NIEs, China and most of original ASEAN member countries have had certain types of special economic zones and succeeded in inviting FDI, although the extent of success varies from country to country. With massive flow of FDI, they have benefited from employment generation, export increase, and technological upgrading.

It should also be noted that China has made full use of its Economic Special Zones, first series of which were designated in 1980, in order to encourage introduction of market mechanism into the country. Foreign investors bring to a host country not only capital and technology, but also various market systems such as contract, accounting, labor market and marketing which did not exist in the centrally planned economy. Although market-oriented economy in Lao PDR is disseminated to more extent than in China, at least, of 1980, the construction of SEZ, leading to inflow of FDIs, will surely accelerate the transition to market economy.

Rationalization of SEZ development in Savannakhet, and the functions and facilities the SEZ should be equipped with, are further examined in Chapters V and VI.

## CHAPTER III REGIONAL BACKGROUND

### 3.1 Human Resources in Savannakhet

#### (1) Employment and Migration

Employment by sector in Savannakhet province, based on 1995 Population Census data, is shown below (Projection for 2010 is also presented for reference.). About 90% of employed persons in Savannakhet are engaged in the agricultural sector. Employment in agriculture means subsistence farmers and unpaid family workers. A person can work as a farmer but temporarily as self-employed in household business or as paid employees. Consequently, the share of “agriculture” tends to appear high.

**Table 3.1 Employment Structure of Savannakhet Province**

	(1000 persons)	
	1995	2010
Population	671.8	970.1
Economically Active Population (Share to Population)	342.0 (50.9%)	494.5 (51.0%)
Unemployed (Unemployment rate)	8.0 (2.3%)	9.9 (2.0%)
Employed (Share)	335.3 (100%)	484.7 (100%)
AGRICULTURE	300.4 (89.6%)	427.0 (88.1%)
INDUSTRY	6.5 (1.9%)	10.8 (2.2%)
SERVICE	28.3 (8.4%)	46.9 (9.7%)

Source: JICA “The Study on the Integrated Regional Development Plan for Savannakhet and Khammouan Project (hereinafter “SKR Study”)

The high concentration of employment on the agricultural sector implies the following:

- (i) Resource mobilization for industrialization has not been made; and
- (ii) Institutional settings for industrialization have not been developed.

The Mekong Lao and Phouthai – two major ethnic groups of the province – mainly live in the lowland areas where permanent (paddy) cultivation is predominant. These two groups have the best opportunities for access to public services. The other groups who live in the highland areas tend to practice shifting cultivation and have less access to education, health, and credits due mainly to the lack of feeder roads.

Illiteracy rates in such highland areas are substantially high. Thus, the division between rural and urban population in terms of economic opportunities is clear. Urban population in Savannakhet province is estimated to be about 102,000 (15%).

Unless people currently engaged in subsistence agriculture shifts to the more productive economic sectors (industry and service), incidence of poverty<sup>1</sup> will not be decreased.

In addition to the rural-urban division of opportunities, the high rate of out-migration is another important issue for Savannakhet province development option. The following table - though a bit dated - shows a strong movement of out-migration from Savannakhet:

**Table 3.2 Population Change 1994/95 of Selected Provinces**

Province	Natural Growth Rate (%)	Migration (%)
OUDOMXAY	2.4	4.3
SAYABOURY	2.9	1.5
SAVANNAKHET	2.4	-7.1
SEKONG	4.0	-2.1
XIENGKHOUANG	3.3	-3.3
National Average	2.6	-2.3

Source: NSC-Basic Statistics 94 and 95, Socio-Economic Profile of Savannakhet Province, UNDP April 1998

The migration rate is calculated as the difference between the population of 1994 and 1995, minus the natural growth rate. As a result of emigration, real population *decrease* rate of Savannakhet in 1994 - 1995 is assumed to be 4.7%. There is an estimate of temporary out-migration to Thailand of close to 20,000 persons per year<sup>2</sup>.

## (2) Development Options

The current employment structure of Savannakhet province suggests that there exist an under-employment problem in the marginal areas. Those people are less likely to have good literacy and education. In other words, they have fewer opportunities to participate in industrial activities compared to those in urban areas. For those living in the marginal areas, basic education and skill development are required, while those living in the urban

<sup>1</sup> Poverty line is assumed to be 18,518 Kip per month. About 37% of population in Savannakhet are below the poverty line.

<sup>2</sup> Socio-Economic Profile of Savannakhet Province, UNDP April 1998

areas require further skill development to accelerate industrialization in Savannakhet. The following two measures are, therefore, necessary for human resources development in Savannakhet:

(i) Expanding Basic Education

The current low enrollment rate and high drop-out rate in basic education are the great obstacles to economic and social development. Appropriate measures should be taken to develop multi-grade teaching system, distance education, and establishment of boarding schools.

(ii) Creating Skilled Personnel and Job Markets

As there is little demand for labor force from industrial sector in Savannakhet Province to date, there is little human resources readily available as worker for industrial production, transportation other services sector. Graduates from vocational schools do not possess adequate skills. This is because of lack of training due to poor facilities and teachings. It is therefore necessary to develop Savannakhet Technical School, which is the largest technical school improve the schools outside Vientiane. Currently it organizes the following 7 courses:

- Carpentry
- Electricity
- Welding
- Personal Computer
- Business Administration
- Auto Mechanic
- Masonry

Total student number is 650 and total staff is 60 in 1999. However, according to the director of the school, the capacity of the school for student is merely 300.

In addition, strengthening of linkage with foreign investors shall be encouraged. For example, Volkswagen together with GTZ established “Lao-German Technical College” in Vientiane. This kind of collaboration arrangement shall be sought further.

300,000 people are engaged in the agricultural sector in Savannakhet while merely 6,500 in industry at present. Hence there is abundant labor force in Savannakhet though majority of them are at present engaged in subsistence farming. Currently unskilled labor may become semi-skilled and skilled workers through training and education mentioned above (Basic education

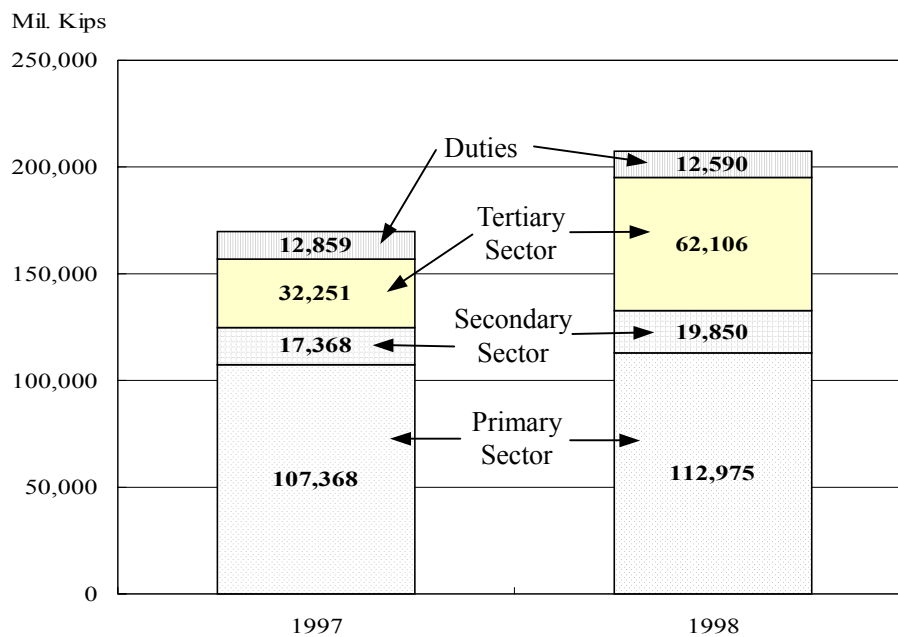


and Vocational Training) and learning by doing on the job. The issue therefore is how to train those people engaged in subsistence farming for industry and service employment.

### 3.2 Savannakhet Economy

#### (1) Gross Regional Product

GRP(Gross Regional Product) in Savannakhet province recorded 170 billion kips in 1997 and 208 billion kips in 1998. The real growth rate per annum was 22.2%<sup>3</sup>. The service sector contributed to such a remarkable growth with its growth rate of 92.6%. The principal sector in Savannakhet, however, remains to be agriculture, which accounted for 63.2% in 1997 and 54.4% in 1998. The industrial sector grew steadily (14.3%), but its contribution to the total GRP declined slightly.



Source: Basic Statistics about the socio-economic development in the Savannakhet province, 1998

**Figure 3.1 Gross Regional Products at 1995 price**

#### (2) Export and Import

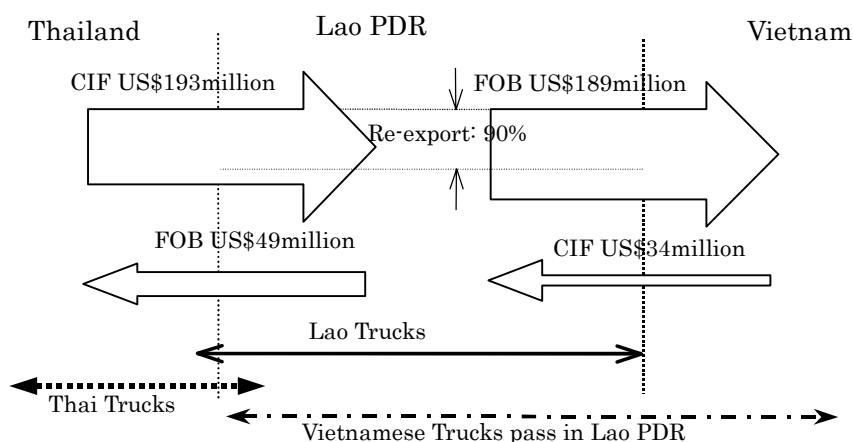
Total value of exports in Savannakhet amounted to US\$238 million in 1998/99. Of which US\$49 million (20.5%) were exported to Thailand and

<sup>3</sup> The real growth rate of GDP at the same period was around 6% per annum. The rate of 22.2% in Savannakhet was unusually high.

US\$189 million (79.5%) to Vietnam. There are two categories of export: one is export of the domestic goods (US\$20 million or 8.5%) and the other is the transit goods (US\$218 million or 91.5%). The domestic goods are mainly exported to Thailand and the transit goods mainly to Vietnam.

Total value of import was US\$227 million in 1998/99. The balance of trade, therefore, was in the surplus of US\$11 million. Imports are categorized as domestic usage and transit. The domestic usage was 9.8% (US\$22 million) and the transit was 90.2% (US\$205 million). The proportion of goods exported from and import to Lao PDR has been relatively small or less than 10%.

Trade activities between Lao PDR and Thailand are highly dependent on the boarder-trade. The regional economy, therefore, is measured by the export and import volume of domestic origin and destination (exclusive of transit goods). The economic activities of Savannakhet are therefore estimated to be 10% of the total exports and imports of the province.



Source: Savannakhet Province and SPC

**Figure 3.2 Trade Structure in Savannakhet**

The major export-import commodities of Savannakhet are summarized as follows:

Export commodities

The manufacturing products, such as garment, accounted for 55.6% to the domestic goods for export, followed by wood and wooden products (31.1%). As for transit goods, agricultural products or foodstuff is predominant (87.5%). Re-export goods are mainly consumption goods

(53.7%), followed by construction materials and sanitary ware (24.0%) and foodstuff (20.1%).

### Import commodities

Imports for domestic usage are principally foodstuff (59.0%), followed by construction materials and sanitary ware (25.9%). Re-export goods are predominantly consumption goods (55.1%).

**Table 3.3 Export-Import Commodities**

<b>EXPORT</b>	US\$	%	<b>IMPORT</b>	US\$	%
Wood and products	3,935	31.6	Foodstuff	13,593	59.0
Mineral	1,172	9.3	Consumption goods	1,726	7.5
Natural forestry products	272	2.1	Construction goods*	5,962	25.9
Agricultural products	55	0.4	Vehicle spare parts	1,212	5.3
Industry products	7,042	55.6	Medical equipment**	537	2.3
Other products	195	1.5	<b>Domestic usage</b>	23,030	100.0
<b>Domestic Goods</b>	12,671	100.0	Equipment for industry	4,404	32.6
Foodstuff	152,556	87.5	Equipment for agriculture	622	4.6
Consumption goods	12,751	7.3	Products for export	8,500	62.8
Construction goods*	4,708	2.7	<b>Import for Factory</b>	13,525	100.0
Vehicle spare parts	4,378	2.5	Foodstuff	1,696	18.7
<b>Transit Goods</b>	174,394	100.0	Consumption goods	5,011	55.1
Foodstuff	1,740	20.1	Industry goods	225	2.5
Consumption goods	4,637	53.7	Construction goods*	1,992	21.9
Industry goods	62	0.7	Vehicle spare parts	72	0.8
Construction goods*	2,074	24.0	Medical equipment**	93	1.0
Vehicle spare parts	110	1.3	<b>Re-export Goods</b>	9,090	100.0
Medical equipment**	21	0.2			
<b>Re-export Goods</b>	8,643	100.0			

\*: Construction goods and sanitary ware

\*\* : Including Medicine

Source: The study of Socio-Economic Impact on the Use of Route 9, SPC

### **3.3 Savannakhet Industry: Situation and Prospects**

Savannakhet province is reported to be an industrial base in Lao PDR, following Vientiane Municipality. There are 1,846 factories employing 7,218 workers in 1999 (excluding electricity and water supply, of which establishments are 194 and employ 614 workers). The large factories having more than 100 employment are 14 and they employ 2,776 workers<sup>4</sup>. The middle factories are 61 with 1,363 employees and the small factories are 1,771 and they employ 3,079 workers.

<sup>4</sup> The Department of Industry and Handicraft in Savannakhet categorizes the establishments as three types: 1) Small factory (less than 9 employments), 2) Medium factory (10-99 employments), and 3) Large factory (more than 100 employments).

**Table 3.4 Factories and Employment by Factory Scale**

	No. of Establishment	(%)	No. of Employees	(%)
Large Factories	14	0.8%	2,776	38.5%
Medium Factories	61	3.3%	1,363	18.9%
Small Factories	1,771	95.9%	3,079	42.7%
Total	1,846	100.0%	7,218	100.0%

Source: Department of Industry and Handicraft in Savannakhet

### Major Sub-sectors

The biggest sub-sector in Savannakhet is the food, beverage, and tobacco industry having 1,463 factories of 2,605 workers. From the point of view of employment, the garment industry is the second largest sub-sector, which employs 1,626 workers followed by the sawmill having 1,109 employment. The above three sub-sectors, therefore, employ 5,340 workers or 74% to the total.

**Table 3.5 Industrial Establishments and their Employment in Savannakhet**

ISIC Code	Sub-sector	Number of Establishment	Number of Employees	Number of employment per establishment
15	Food and beverages*	1,463	2,605	2
16	Tobacco products	1	51	51
18	Wearing apparel	26	1,626	63
192	Footwear	1	1	1
201	Sawmill and plating of woods	12	1,109	92
21	Paper and paper products	1	146	146
22	Publishing and printing	1	17	17
24	Chemicals and chemical products	1	21	21
25	Rubber and plastics	5	131	26
26	Other non-metallic mineral products	65	585	9
27	Manufacture of basic metals	4	61	15
28	Fabricated metal products, except machinery and equipment	24	125	5
29	Machinery and equipment	12	41	3
32	Radio, television and other electronics equipment and apparatus	37	158	4
333	Watches and clocks	20	20	1
341	Motor vehicles	26	133	5
359	Transport equipment n.e.c.	146	382	3
361	Furniture	1	6	6
	Total	1,846	7,218	4

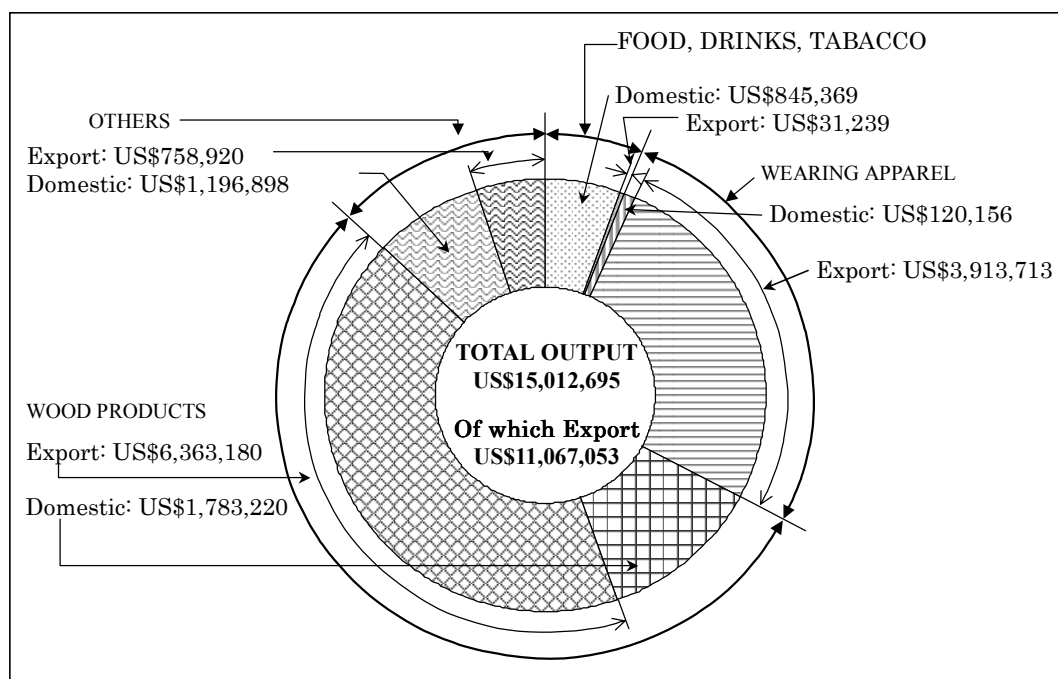
Source: Department of Industry and Handicraft in Savannakhet

Regarding to the number of establishments, the manufacture of transport equipment n.e.c. (Not elsewhere classified) is the second largest sub-sector, however, most of their business is repair works of bicycle and motorbike.

### Factories Located in Savannakhet

Large factories (14 factories) and 59 Medium-sized factories are located in Khanthabouly district and the employment are 4,139. As for the small factories, there are 413 factories and they employ 1,128 workers in Khanthabouly district. 5,276 workers or 73% of Savannakhet province are employed in Khanthabouly district.

Out of the 75 large and middle factories, 31 factories are located in the Savannakhet (Urban area of Khanthabouly district) and along the Route 9. The number of employees of the factories is 3,249. Twenty factories are export-oriented and total amount of export is around US\$11 million (1999).



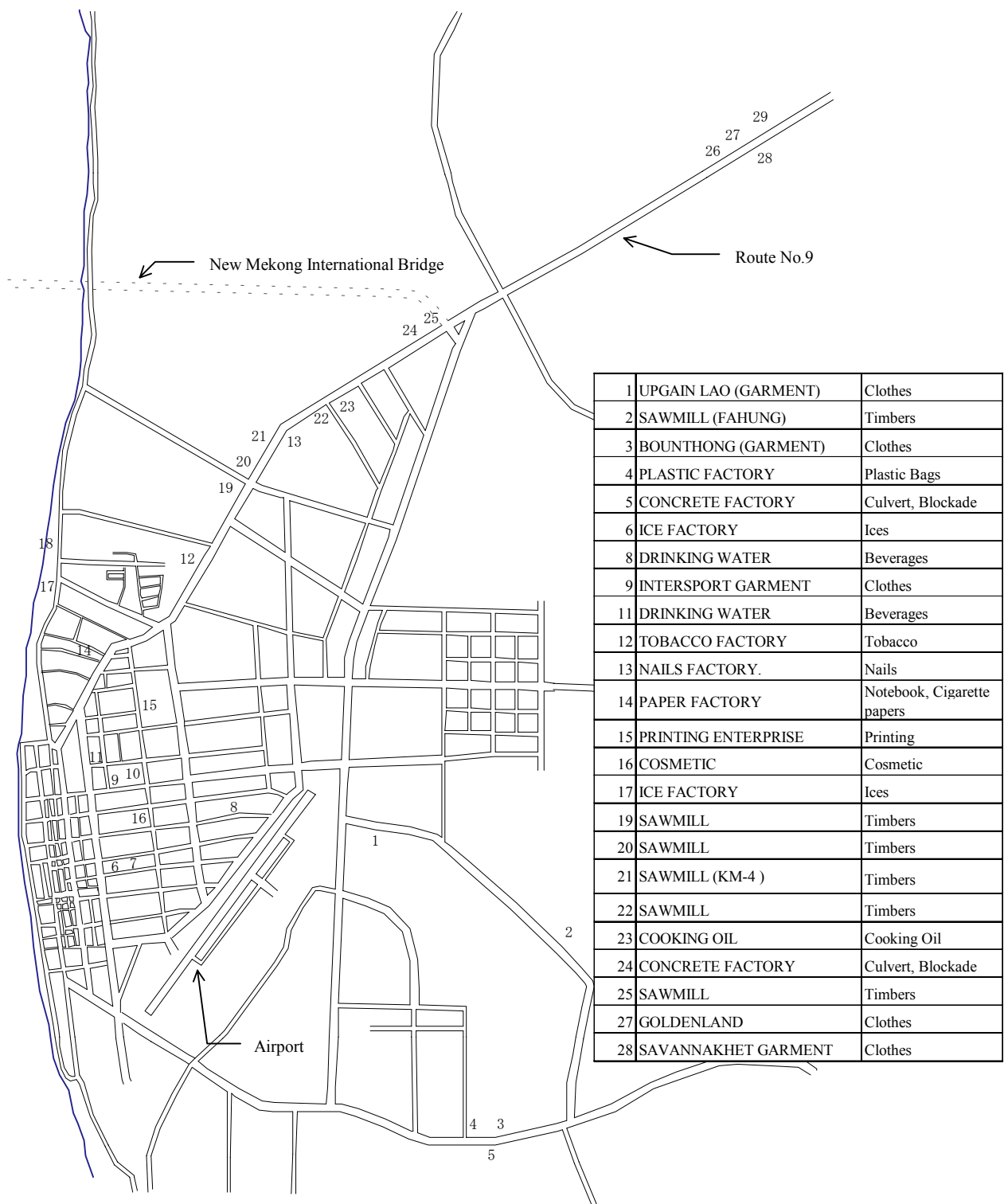
Source: Savannakhet Province

**Figure 3.3 Shipment and Export by Major Sub-sectors**

**Table 3.6 Factories along Route 9**

	No.	SALES (\$)	EXPORT (\$)	EMPLOYEES
FOOD, DRINKS, TABACCO	7	876,608	31,239	214
WEARING APPAREL	5	4,033,869	3,913,713	1,523
WOOD PRODUCTS	11	8,146,400	6,363,180	1,094
OTHERS	8	1,955,818	758,920	418
<b>TOTAL</b>	<b>31</b>	<b>15,012,695</b>	<b>11,067,053</b>	<b>3,249</b>

Source: Savannakhet Province



Note: The factories numbered 7,10,18,26, and 29 are closed or in preparation. There are ten more factories located along the Route No.9 to the junction with Route No. 13.

Source: The Savannakhet Province

**Figure 3.4 Factory Location Map along Route No. 9**

Activities and future prospective in major industry in Savannakhet are summarized as follows.

(1) Garment industry

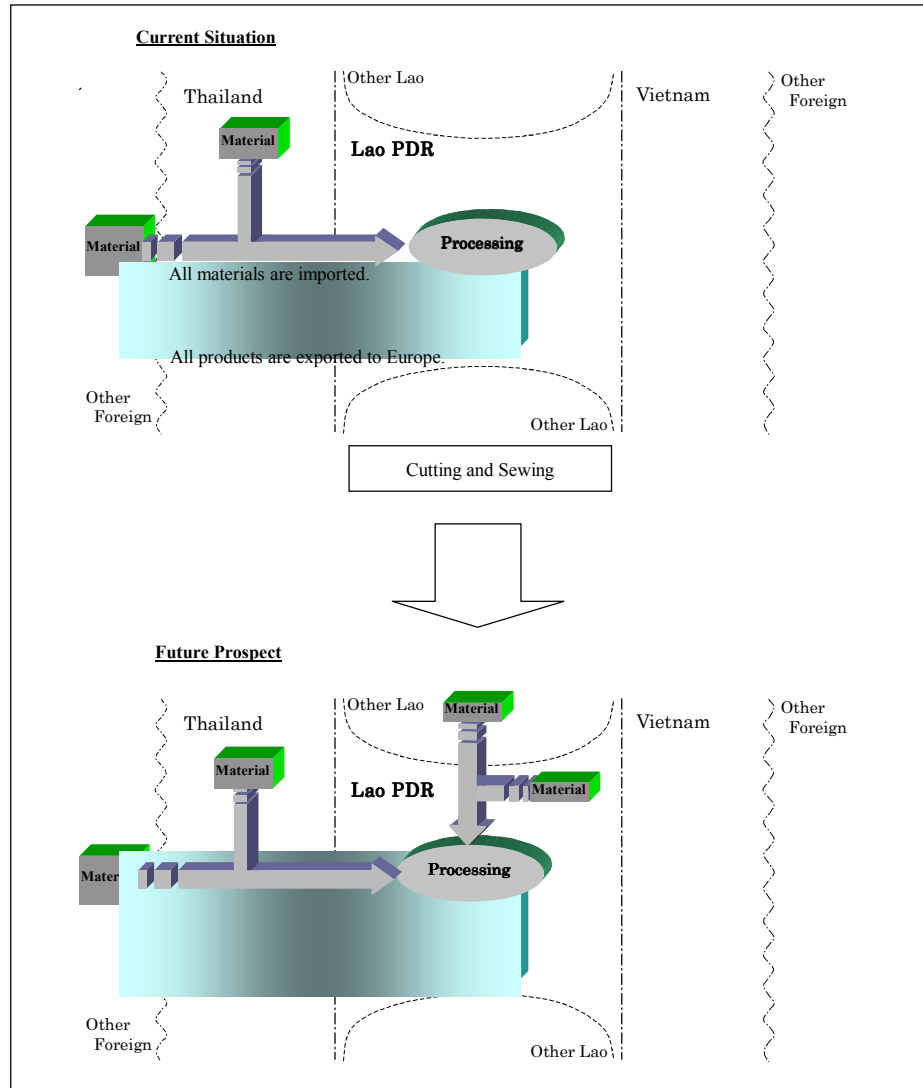
The garment industry is one of the major export sub-sectors in Lao PDR. In Savannakhet, there are 6 garment factories in operation, contributing to the export. All the garment factories import the whole materials, process (cutting and sawing) and export all products mainly to Europe.

There are several discussions as to whether the garment industry is a promising industry to promote in Savannakhet. The points of discussion are:

- i) As the garment industry is a typical labor-intensive industry, the labor supply is relatively limited, and
- ii) The garment industry is a prime motor of export; however the impact to the national and regional economy is relatively small because of its value added in production process.

These points of discussion are true from the macroscopic point of view. In case of the promotion in Savannakhet, however, the labor force should be carefully assessed. In 1995, provincial population was about 671,000, and it is expected that 2010 population will reach nearly 970,000. The number of employment in agriculture was around 300,000 in 1995 and the increased rate of agricultural employment will be much less than the population increase rate. When 20,000 to 30,000 jobs are to be created by the garment industry (with the existing garment factories employing 200 to 700 respectively, about 30 factories are possible to locate), the labor supply is not considered to be a negative factor for the garment industry in Savannakhet.

With respect to the cost competitiveness, the wage of the garment industry in Savannakhet is reported to be 25% of Bangkok and a half of northeastern Thailand. If the productivity in Savannakhet is 80% when compared to the Thai workers, the processing in Savannakhet has an advantage of 62%-cost-reduction effect compared to that of Bangkok and of 20% to Mukdahan.



**Figure 3.5 Commodity Flow of Garment Sector**

On the other hand, there are some issues, to be addressed in evaluating the prospectiveness to promote the garment industry in Savannakhet.

- i) Quantity of potential labor force is sufficient but labor force is not yet accustomed to the “factory work”.
- ii) There is limited supply base of domestic material to the garment industry.
- iii) The effects of expiration of MFA (Multi-Fiber Agreement) in 2005 should be further assessed.

(2) Wood and wooden products

Wood and wooden product sub-sector is a promising industry in Savannakhet. The wood and wooden products, in fact, are major export



commodities. The export products, however, are mainly timbers, with low level of processing. The wood and wooden products industry has been losing opportunities to gain the higher value-added. In order to enhance the degree of processing, existing sawmills in Savannakhet have to modernize their equipment. Promotion of FDI and training of workers will be further required to promote the furniture industry.

The potential market of the construction materials such as a floorboard made by “hard wood” is big. In Canada, for example, the consumers prefer to use the hard-wood-made floorboard rather than that made by “soft wood”, which is rich in Canada. This is an example of new business opportunity for wooden products development based on the Study Team observation. Presumably there are many such business opportunities for local resource-based industry.

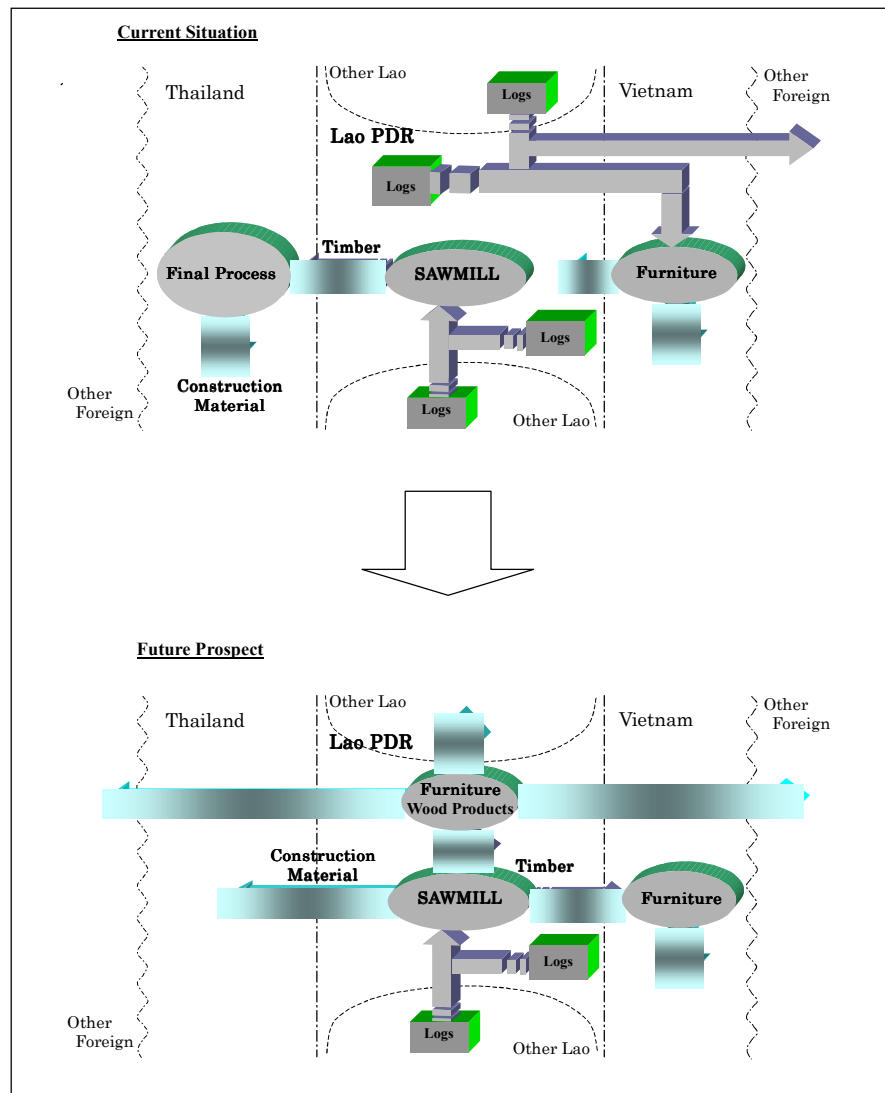


Figure 3.6 Commodity Flow of Wood / Wooden Products

### (3) Food Processing

Lao PDR is an agricultural country, and the food processing industry is promising as a local resources-based industry. It should be emphasized, however, that the supply systems of agricultural products are to be secured to promote the food industry.

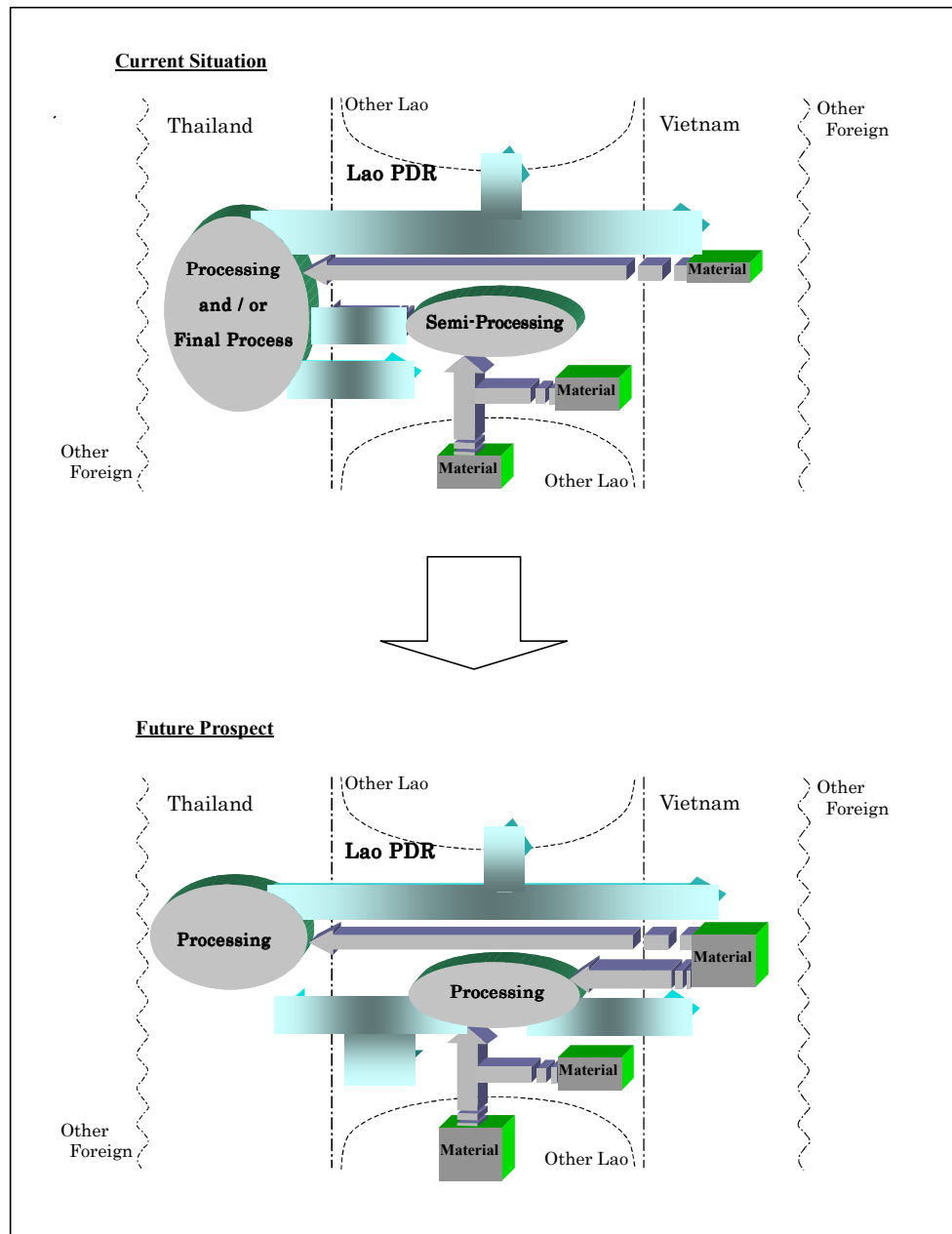
A vegetable oil manufacturer, located in Savannakhet, for example, suffers from a shortage in supply of raw materials (mainly peanut). Such shortage of materials obstructs investment in final processing equipment. The factory, therefore, produces intermediate products and sends them to Thailand where final products are processed and re-imported to Lao PDR. To raise the processing degree and to gain value-added in Lao PDR, stable supply of raw materials is essential.

In Savannakhet, the food and tobacco industry is the important sub-sector, as mentioned above. Most food and tobacco manufacturers, however, are small factories. Of them, 1,365 factories or 93% of the total are rice mills, which spread throughout the whole province, they employ 2,037 workers followed by the manufacture of other food products such as bakery, noodle, salt and coffee (35 factories and 224 workers).

**Table 3.7 Manufacturing of Food and Tobacco in Savannakhet**

ISIC Code		Factories	Employment
151	Production, processing and preservation of meat, fish, fruit, vegetables, oils and fats	1	25
152	Manufacture of dairy products	35	127
153	Manufacture of grain mill products, starches and starch products, and prepared animal feeds	1,365	2,073
154	Manufacture of other food products	35	224
155	Manufacture of beverages	27	156
160	Manufacture of tobacco products	1	51
	Total	1,464	2,656

Source: Department of Industry and Handicraft of Savannakhet Province



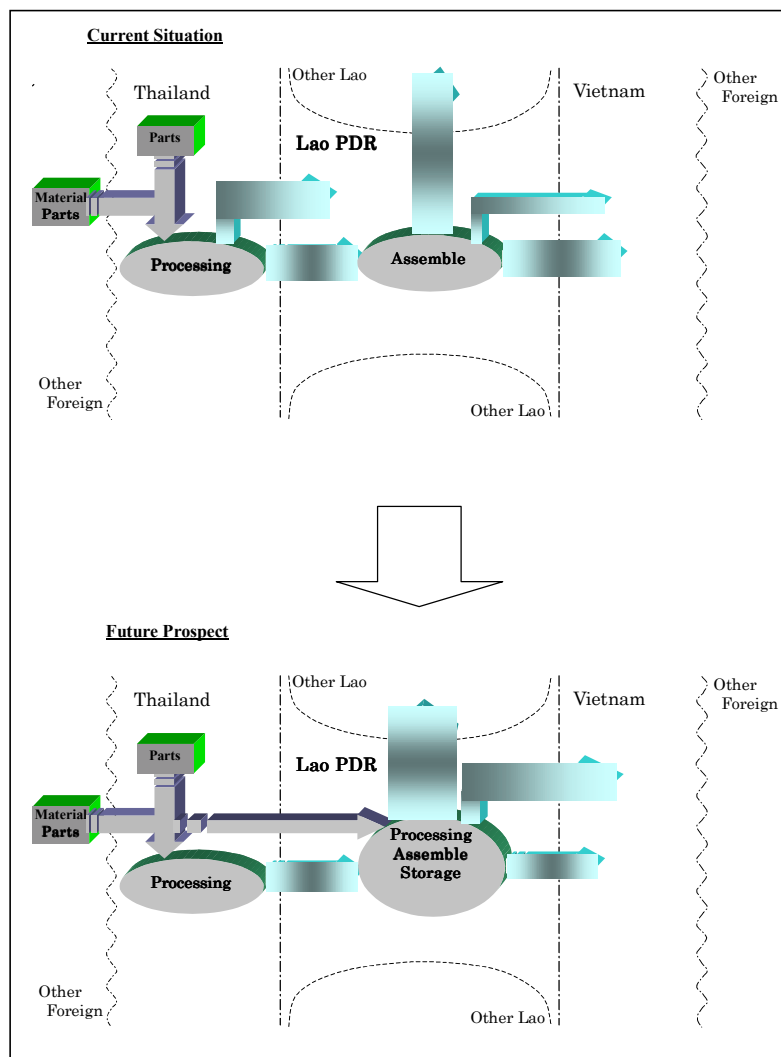
**Figure 3.7 Commodity Flow of Foodstuff**

(4) Machinery, Electrical and Electronics Equipment

There are four motorcycle factories operating under the Complete Knock Down (CKD) system in Lao PDR, but the total assembling capacity is limited to not more than 20,000. The government sets the quotas for motorcycle assembly. The import duties for CKD parts have been decreased to 61% (it remains still high), but the duties for the final products have also been reduced to the same level. The merit of CKD production is therefore being lost. The role of re-export base to Vietnam will be decreased as the factories in Vietnam are increasing their capacity for assembling.

CKD assemblers, therefore, should focus on the domestic market, which will gradually expand with the increase in income level. They will find it difficult to survive if the quota system is imposed and the import duties for parts are at the same level of the duties for the final products.

In Savannakhet, there is an electrical equipment factory producing electric fans; its production process is to import major parts from Thailand (motor, electronics devices, etc.), to produce plastic parts, and to assemble them. The factory was designed to assemble the consumer electrical equipment such as refrigerators, TVs, air-conditioners, and fans and to meet domestic market demand and export to Vietnam. Due to a shrinking market in Vietnam and Lao PDR, the production of the factory has been reduced substantially. Lessons from this case suggest that the local processing of parts should be promoted, and that some measures should be taken to complement some target industry/products.



**Figure 3.8 Commodity Flow of Machinery / Electronics**

### 3.4 Transportation and Hotel Industries

The transportation industry in Lao PDR is considered as an “infant industry”. There are only 215 trucks. In Savannakhet, there is one transportation company with 29 trucks. When the New International Mekong Bridge is completed, the total amount of the traffic volume will be tremendously expanded as shown in Section 2.6. It is a big opportunity for the transportation companies to enhance or expand their business. The Facilitation of Cross-border Transport of Goods and People Agreement among Lao PDR, Thailand, and Vietnam were agreed. The essence of the agreement is to allow the transportation companies in each country to make business freely so the competition among the three countries will be much serious.

Technological progress in the logistics has been very fast. Productivity improvement utilizing new technology like IT is therefore required. In order to adopt such a strategy, economy of scale may be required. Economy of scale means the more that is produced the cheaper is the price of each operation. Thus, merger of some transportation companies may enhance their competitiveness.

**Table 3.8 Transportation Companies and Number of Trucks**

No	Name of Enterprise Co & Association	Location	Number of Truck
	<u>Companies permitted by Sector Cooperatives</u>		
1	O T O 1 Trade Transportation Co. Ltd.	Vientiane	52
2	O T O 2 Trade Transportation Co. Ltd.	Savannakhet	29
3	O T O 3 Trade Transportation Co. Ltd.	Vientiane	13
4	O T O 4 Trade Transportation Co. Ltd.	Vientiane	33
5	Trade Transport Enterprise no. 1	Vientiane	22
	Total		149
	<u>Private-Partnership Transportation Companies</u>		
1	Machinery Transport Service Co. Ltd.	Vientiane	44
2	Muang Luang Service Co. Ltd.	Vientiane	10
3	DAFI Petroleum Transportation	Pakse	n.a.
4	Lao Southern Developing Transportation Co. Ltd.	Pakse	n.a.
5	Phou Doy Transportation Co. Ltd.	Vientiane	11
	Total		65

Source: Department of Transport, MTCPC

There are 8 hotels having 245 rooms and 14 guesthouses having 177 rooms. The number of rooms is increasing slightly.

The facilities of hotels are poor and their grade is far below the international standard. The training for the workers appears to be insufficient.

When the New International Mekong Bridge is completed and the foreign businessmen visit Savannakhet, the quantity and quality of the hotels shall be very important. Currently it is difficult to organize meetings and/or seminars in Savannakhet.

**Table 3.9 Hotel and Guesthouse**

	1995	1996	1997	1998
Number of Hotels	7	8	8	8
Number of Rooms	201	227	227	245
Number of Guesthouses	4	8	10	14
Number of Rooms	34	70	99	177

Source: Basic Statistics, Department of Planning for Savannakhet Province, 1998

### **3.5 FDI in Savannakhet**

Since 1990 up to mid 2000, 22 FDI projects, which accounts for just 3% of the total number of FDIs in Lao PDR, with a total amount of US\$33 million have been made in Savannakhet Province (See Table 3.10). Although detailed data including total employment, output and exports is not available, There is no doubt that their operation has a significant impact on the local economy.

Of all 22 projects, 14 are in the industry sector, 2 in agriculture, one in construction and remaining 5 in the services sector. Country-wise, China has the largest number of investments, committed 6 projects in Savannakhet, followed by Thailand with 5, Vietnam with 3, and South Korea with 2 projects. The biggest ever project is Upgain Manufacturing Company, a 100% Thai-invested garment factory, with an investment of US\$11 million.

**Table 3.10 Foreign Direct Investment in Savannakhet Province (1990-2000)**

	Company	Business	Form	Limit Year	Country	Total Value: US\$	Share in %	
							Local	Foreign
<b>I</b>	<b>INDUSTRIAL SECTOR</b>					<b>28,374,657</b>		
1	CIGARETTE FACTORY	Cigarette	JV	20	China	1,500,000	40	60
2	SAVAN-GARMENT	Garment	JV	20	France	307,268	50	50
3	VANNAVIT C.P.	Electric parts	JV	15	Thailand	400,000	50	50
4	GOLDEN LAND	Garment	WF	15	Thailand	990,000		100
5	UPGAIN LAO	Garment	WF	15	Thailand	10,950,000		100
6	SAVAN ADVANTAGE FACTORY	Vegetable oil	WF	20	Thailand	200,000		100
7	LANEXANG MIN.	Mining survey	WF	20	Australia	5,000,000		100
8	NAILS FACTORY	Construction material	JV	15	China	300,000	55	45
9	KOLAO DEVEL'T	Car repair, assemble	JV	15	South Korea	1,740,000	10	90
10	K & L ENTERPRISE	Machine repair	JV	15	South Korea	5,000,000	5	95
11	IRON FACTORY	Steel	JV	20	Vietnam	723,000	50	50
12	ELECTRIC CABLE	Small size cable	JV	25	China	363,889	49	51
13	SOCKS FACTORY	Socks production	WF	15	Japan	900,000		100
14	MOTOBIKES ASSEMBLY	Motorbike repair, sales	WF	20	China	500		100
<b>II</b>	<b>AGRICULTURE</b>					<b>300,000</b>		
15	SAVAN PHATANA AGRICULTURE	Animal breeding	JV	15	Taiwan	300,000	30	70
16	D C VA TRADING	Export agricultural products	WF	15	Thailand	167,000		100
<b>III</b>	<b>CONSTRUCTION &amp; COMMUNICATION</b>					<b>600,000</b>		
17	BRIDGE & ROAD CONSTRUCTION.	Construction	JV	10	Vietnam	600,000	50	50
<b>IV</b>	<b>SERVICES</b>					<b>9,018,368</b>		
18	URBAN DEVELOPMENT PROJECT	Hotel	JV	10	Vietnam	77,331	25	75
19	MEKONG HOTEL	Marketing	JV	20	Singapore	4,302,199	25	75
20	NANHAI HOTEL	Hotel	WF	15	China	3,650,000		100
21	MEKONG RESORT	Guest house	JV	10	Finland	720,000	30	70
22	SAVAN-NANHAI TRADING COMPANY	Service	JV	15	China	268,838	5	95
	<b>TOTAL</b>					<b>38,293,025</b>		

Note: JV - joint venture, WF - wholly owned by foreign enterprise. Two branch offices of Vientiane companies are excluded from investment amount.

Source: Department of Planning, Savannakhet Province

### 3.6 Transportation System

#### (1) East-West Economic Corridor

A concept of the East-West Economic Corridor proposed by ADB is to link major cities and towns located between Mawlamyine (Myanmar) and Danang (Vietnam) via Konkaen (Thailand), Mukdahan (Thailand), and Savannakhet (Lao PDR) as illustrated in Figure 2.9 below. The corridor crosses the center of the Indo-china peninsula. It forms a land bridge

between the South China Sea and the Andaman Sea. It should be noted that the ADB proposed corridor is characterized by the fact that the corridor excludes the principal industrial and consumption bases in the four countries (e.g., Bangkok, Ho Chi Minh City, and Hanoi).



The East-West Economic Corridor proposed by ADB is illustrated as the arrow from Danang (Vietnam) to Mawlamyine (Myanmar) through Savannakhet (Lao PDR.), Mukdahan, Khon Kaen, and Maesot (Thailand), while the current commodity flow is illustrated as the dotted arrows from Bangkok to Udonthani and Ubon in Thailand and to Vinh (Vietnam) through Nakhon Phanom and Thakhek.

**Figure 3.9 East-West Economic Corridor and Commodity Flow**

From the viewpoint of mid-term economic development in GMS, at least one or two large markets should be integrated as the prime engine to increase commodity flow along the Corridor.

The major ports in the region are Laem Chabang (Thailand), Hai Phone, Danang, and Vungtau (Vietnam)<sup>5</sup>, which are gateways to the global markets;

<sup>5</sup> There is a plan to construct the new port in Hatinh Province in Vietnam. It should be included in the further study when the detail of the plan is identified.



therefore the corridor should be connected to the gateway(s). The East-West Corridor in the eastern part is to be considered as a route from Bangkok to north and/or central Vietnam through the central and southern part of Lao PDR. The following routes are to facilitate commodity flow in the region.

- (i) Bangkok<sup>6</sup> – Udonthani – (Friendship Bridge) – Vientiane – (Route 13, Route 8) – Vinh – (Route 1 / Route 10) – Hanoi / Hai Phong
- (ii) Bangkok – Nakhon Phanom – (Ferry) – Thakhek – (Route 13/12, Route 8) – Vinh - Vinh – (Route 1 / Route 10) – Hanoi / Hai Phong
- (iii) Bangkok – Mukdahan – (New Mekong Bridge) – Savannakhet - (Route 13/12, Route 8) – Vinh - (Route 1 / Route 10) – Hanoi / Hai Phong
- (iv) Bangkok - Mukdahan – (New Mekong Bridge) – Savannakhet – (Route 9, Route 1) – Danang
- (v) Bangkok – Ubon – Pakse – (Route 18) – Danang

Along the five routes, Savannakhet relates to two routes, (iii) and (iv). After the construction of the New Mekong Bridge and improvement of Route 9, Savannakhet will be the access point to connect Bangkok and north/central Vietnam. Subject to capacity expansion and fee reduction at Danang Port, the link from Savannakhet to Danang is expected to be a gateway to the East Asian Market (e.g., Taiwan, Korea and Japan).

To identify the role of Savannakhet, the projection of traffic and commodity volume after completion of the new Mekong Bridge has been reviewed. Based on the actual traffic volume of 70 heavy trucks per day in 1997, the traffic in 2005, 2010, and 2020 is estimated as shown below.

**Table 3.11 Daily Traffic Crossing the Bridge: (trucks per day)**

	Long Distance	Local	Total
2005	126 - 210	21 - 34	147 - 244
2010	175 - 385	28 - 63	203 - 448
2020	343 - 1,300	52 - 206	395 - 1,506

Source: SAPROF REPORT, JBIC1998

<sup>6</sup> Laem Chabang Port is included in Bangkok area.

If an average volume carried by each truck is assumed to be 12 tons, the annual commodity volume between Lao PDR and Thailand is estimated as follows:

**Table 3.12 Annual Commodity Volume between Lao PDR and Thailand: (tons)**

	Long Distance	Local	Total
2005	453,600 - 756,000	75,600 - 122,400	529,200 - 878,400
2010	630,000 - 1,386,000	100,800 - 226,800	730,800 - 1,612,800
2020	1,234,800 - 4,680,000	187,200 - 741,600	1,422,000 - 5,421,600

Source: SAPROF REPORT, JBIC 1998

(2) Prospective role of Savannakhet

In order to identify the prospective role of Savannakhet, the current situation and future prospects are assessed as summarized below

1) Industry

The current situation of industrial development in Savannakhet is summarized as follows:

- Industrial and capital accumulation in Savannakhet is small;
- Export oriented industries are garment and wooden products;
- Import substitution industry is a nail production but its scale is small;
- Processing level of wooden products is premature<sup>7</sup>; and
- Food processing manufacturer faces the material supply problem<sup>8</sup>, and

The future prospect for industrial development are summarized as follows:

- FDI in the manufacturing sector should be promoted,
- Export oriented industry, such as foodstuff, is to be promoted,
- Wood and wooden products are required to enhance the processing level<sup>9</sup>, and

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<sup>7</sup> The wooden products for exports are mainly panels and boards for construction to the Thailand. As for the Vietnam, it is exported as logs predominantly to be used as furniture.

<sup>8</sup> In case of cooking oil products, shortage of local material (peanuts) is the obstacle to produce the final goods. The refinement of peanuts-oil is only in the intermediate process at the Savannakhet factory. The final refinement is processed in Thailand and re-import to Lao PDR as the final products.

<sup>9</sup> The technical level of Lao sawmill companies is low compared with the Vietnamese furniture manufacturers. The processing level should be raised by the technical assistance of the foreign companies.

- Light processing such as packaging and labeling will be promoted, subject to expansion of trade volume.

From the industrial viewpoint, Savannakhet will be the center of light-processing industry and local-resource-based industry<sup>10</sup> in southern Lao PDR.

## 2) Commodity flow

The current situation of commodity flow in the region is summarized as follows:

- Currently the major route of commodity flow between Thailand and Lao PDR is from Nonkai to Vientiane, followed by the route between Nakhonphanom and Takhek. The trade volume of Mukdahan -Savannakhet route is smaller than the above two routes, and
- The trade volume between Thailand and Vietnam via Lao PDR will gradually increase and the transportation route in Lao PDR will be Route 8 and Route 9.

When the New Mekong Bridge is constructed and the Route 9 is improved, the commodity flow will be changed. The future prospect of commodity flow is considered as follows:

- The New Mekong Bridge makes the transport route shift from the Nakhonphanom – Takhek route to Mukdahan – Savannakhet route,
- The commodity flow between Thailand and Vietnam via Lao PDR, therefore, will be shifted to utilize the two routes: Savannakhet – Vinh via Rout 13 and 8 to the north Vietnam, and Savannakhet – Danang via Route 9 to the central Vietnam, and
- The domestic goods produced in the central and southern Lao PDR will be collected to Savannakhet and exported to Vietnam and to Thailand.

## (3) Role of Savannakhet

Under the concept of the East-West Economic Corridor in the eastern part and future perspectives, Savannakhet will have the following functions:

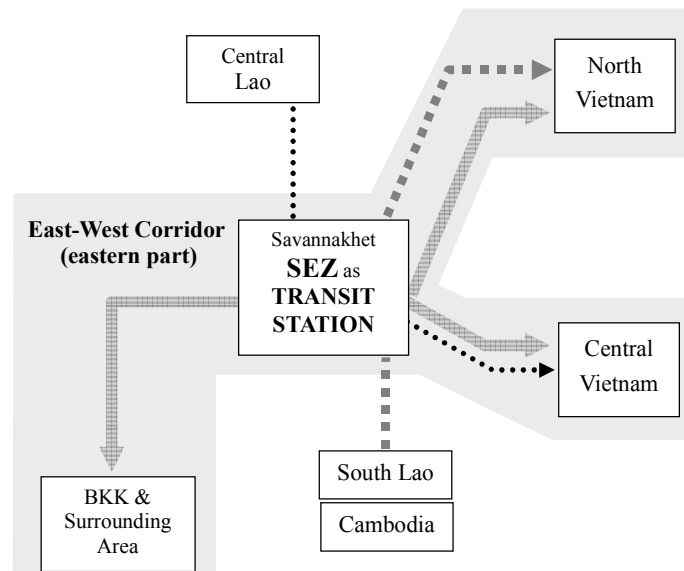
- The industrial center of the central and southern Lao PDR,

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<sup>10</sup> They include the FDIs.

- The transit station of the domestic export goods to Thailand and Vietnam, and
- The international transit station of the goods between Thailand and Vietnam.

The prospective role of Savannakhet is considered as illustrated below.



**Figure 3.10 Role of Savannakhet in East-West Corridor**

### 3.7 Opportunities and Constraints

#### (1) Opportunities

By reviewing the social and economic background as noted above, it becomes clear that Savannakhet province has the following opportunities:

- **Rich forestry resources:**  
Savannakhet province is rich in forestry resources, and has potential to attain higher value added in the wood and wooden product industry.
- **Abundant land and water resources:**  
There extends a vast land for agricultural development and resultant development in the agro-based industry. The region also has abundant water resources from the tributaries of the Mekong River.
- **Direct access to Thailand through the new Mekong bridge**  
There are many examples that economic activities in the less developed areas are enhanced by directly connecting to the advanced area. The New

Mekong Bridge will create business opportunities for all the economic sectors by connecting directly to Thailand.

- Shorter time-distance to Central Vietnam:  
Route 9 when improved will shorten the time-distance between Savannakhet and the central Vietnam. It brings about expansion of markets.
- Junction of the north-south axis and east-west axis:  
In addition to the east-west connection, Savannakhet locates at the junction of the east-west corridor and the north-south axis in GMS. Such a location of Savannakhet will provide various business opportunities (e.g. import – processing – re-export / sales to domestic market, collecting the domestic goods – processing – export, etc.)
- Dual directions to North and Central Vietnam from Thailand:  
Savannakhet will develop multiple routes from Thailand to north/central Vietnam. If Savannakhet locates only on the route between Bangkok and Danang, less attractiveness is expected by transporters, exporters, and other investors.

## (2) Constraints

Major constraints of Savannakhet province for economic development will include the following:

- Limited population and labor supply:  
Savannakhet province has a low population density, and supply of readily available labor is limited. It has disadvantage to attract large-scaled labor-intensive industries to Savannakhet.
- Lack of skilled workers:  
The limited industrial accumulation in Savannakhet causes limited supply of skilled labor.
- Weakness in transportation industry:  
Transporter is a major player in the free trade regime. Though the role of Savannakhet as its logistic center will increase after completion of the New Mekong Bridge and improvement of Route 9, the weakness of transporters in Savannakhet will make such a big business opportunity lost.

- Limitation in telecommunications:  
Telecommunications in Lao PDR remains at the infant stage. Between Vientiane and Savannakhet, the capacity of the telecommunications line is quite limited. As the telecommunications has become one of the most important business infrastructures, this limitation will be a large obstacle in enhancing economic activities. There is no Internet access point in Savannakhet.
- Weakness in marketing:  
Due to remoteness from the world markets, Savannakhet province has had limitation in marketing. Raw materials produced in Savannakhet have been processed more in Thailand and Vietnam.

Several constraints of Savannakhet are pointed out above. There is a reference model country for a small country like Lao PDR where conventional economies of scale are not applied. Costa Rica – a small country with 4 million people in Central America – has made considerable success in achieving two of their goals; increased export and FDI. Costa Rica now set its future direction as “K (Knowledge) – economy”.

#### **K-Economy – Costa Rica**

*High levels of education, a prosperous economy, low crime rates and calm politics have long set Costa Rica apart from its troubled neighbors. You might call it the Sweden of Central America. – The Economist, November 11TH 2000*

After stagnating in the mid-1990s, Costa Rican economy surged. Its GDP grew almost 8% in 1999. Increased export and Foreign Direct Investment are the two factors that contributed to the high economic growth. Its population is merely 4 million. Enterprises in Costa Rica, therefore, can not rely solely on internal market or other central American countries’ market. Costa Rican government was very much aware of the necessity to penetrate into foreign markets.

Costa Rica’s reputation as a stable place, full of skilled workers has long attracted foreign investors. Most recently Intel, which opened its only Latin American chip factory in Costa Rica in 1998. The increase in chip exports (\$2 billion) gave Costa Rica a trade surplus for the first time since 1986. Intel created employment opportunities for 2,000 people. 90% of them have had tertiary education. Computer literacy training is very common. Computer classroom is available at about a half of the primary school.

The government plans to keep growth going by seeking more foreign investment. Manufacturers who export their output get an eight-year tax exemption. Other Central American countries offer more generous incentives but Costa Rica has other advantages. These include democratic tradition, respect for the rule of law and an well-educated workforce.

In addition to computer related production, software development is also booming in Costa Rica. More than 100 software development companies currently operate in Costa Rica, employing more than 1,000 professionals. Total exports of the sector are close to \$200 million.

Costa Rica, according to the Minister of Trade, is seeking to develop its Knowledge-based economy (K-economy). Costa Rica’s well educated and highly motivated citizens are the building blocks to enter the Information Era.

These opportunities and constraints will be taken into account in the discussions on objectives, strategies, and functions of SEZ development in Savannakhet in Chapter VI.

(3) Potential Gains for Savannakhet SEZ

NAFTA has bound Mexico into the global high-tech economy and the European Union has developed new trading arrangements with North Africa and Central Europe. These preferential approaches may greatly help the immediate beneficiaries, but harm more distant regions by drawing FDI and trade away. Trade routes linking marginal traders with major markets are much less competitive than the high-volume routes.

A new approach is necessary in helping marginalized regions like Savannakhet to connect to the world economy. The WTO rules reject the application of special incentives to attract FDI, such as export-processing zones and tax holidays, even though these methods have worked for others. When Costa Rica wanted to attract Intel, it gave incentives. Israel has done the same. Ireland's rapid growth was supported by low rates of corporate tax applied to foreign investments.

Potential gains for establishing Savannakhet SEZ are summarized below.

**Table 3.13 Potential Gains from Savannakhet SEZ**

Potential gains	Remarks
• Linkages with trade partners	In addition to the New Mekong Bridge and the improved Route 9, incentives and facilities are required to attract investments to marginalized region.
• Job creation	Increasing urban population has to find means of livelihood due to decreasing employment opportunities in agriculture
• Development of industrial labor force through Labor training and Learning by doing	People engaged in subsistence agriculture are not accustomed to industrial work. These people will acquire the work discipline.
• Management practice	Technological transfer, knowledge spillover for domestic entrepreneurs.
• Demonstration effects	It can be a good laboratory to experiment with the market economy.
• Provision of Industrial and Service Structure in Savannakhet	Savannakhet and/or Lao PDR do not lose what they did not get (tax and tariff revenue).

## CHAPTER IV INVESTMENT DEMAND

### 4.1 Trend of FDI in Asian Countries

As seen in Section 2.3, Asian countries account for more than 85% of FDI value in Lao PDR, with Thailand being by far the largest investor. It is therefore meaningful, in order to explore investment demand to Lao PDR, to look into the trend of FDI flow from and to Asian countries. For Savannakhet Province, two neighboring countries, Thailand and Vietnam, in particular are the most prospective investors because access from/to these countries will be facilitated in the near future, and the progress of regional cooperation within the framework of ASEAN economic integration may promote further investment.

#### (1) FDI from/to Asian Countries

Figure 4.1 shows FDI flow from seven East Asian countries. FDI from East Asia in total peaked in 1996 but decreased in 1997 and 1998 obviously due to the Asian economic crisis. While FDI from most countries decreased in 1997 or 1998, or both years, FDI from China increased, though by a small amount, in both years. Thailand and Indonesia, the hardest hit countries by the economic crisis, have reduced their FDI significantly.

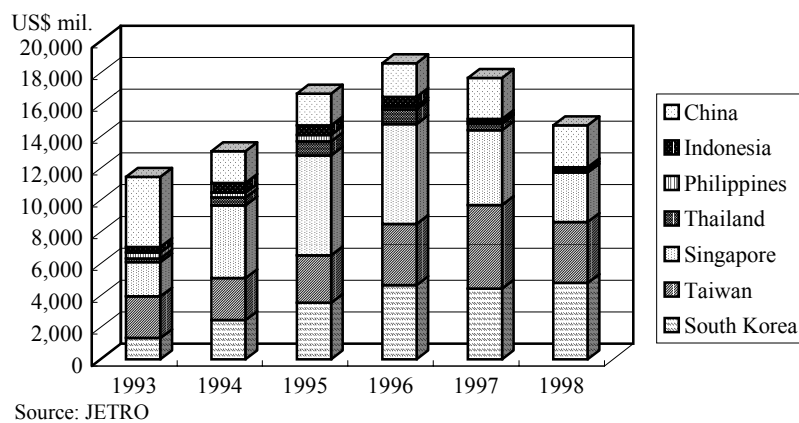
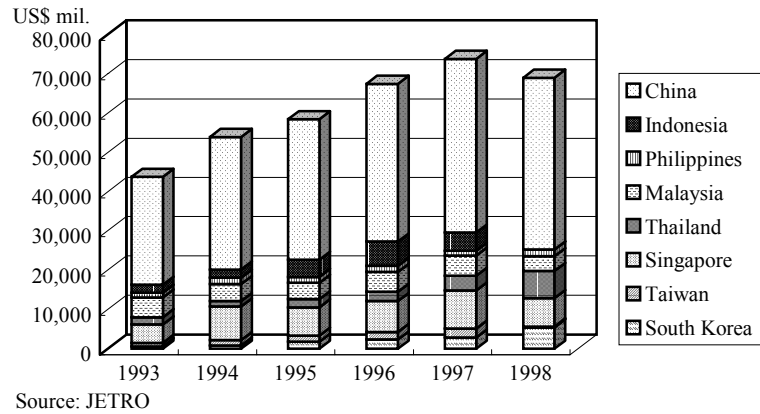


Figure 4.1 FDI Flow from Asian Countries

Figure 4.2 shows FDI to eight East Asian countries. FDI flow to the region has rapidly increased until 1997, but FDI value dropped by 7% in 1998. However, a closer look at the figures reveals that whereas Taiwan, Singapore, Malaysia, and Indonesia contributed much to the decrease in 1998, South Korea, Thailand, and Philippines saw an increase in FDI inflow. This was due to their deregulation in FDI in a bid to recover from the economic crisis.





**Figure 4.2 FDI Flow to Asian Countries**

Although at the moment FDI flows both from and to Asian countries are not as vigorous as before the Asian economic crisis, it is expected that East Asian countries will soon start enhancing FDI activities again as they are showing satisfactorily quick recovery.

As for Japan's FDI (Table 4.1) for the last four fiscal years 1995-1998 (April to March), Asian share has been around 20%. However, in 1998 the total value of new FDI by Japan dropped sharply and the FDI to Asia in particular shrunk to almost half of the previous year. This is attributed mainly to the economic crisis of East Asia and partly to Japan's continued recession.

**Table 4.1 FDI from Japan**

	Unit: Million US\$				
	FY1995	FY1996	FY1997	FY1998	FY1995-98
<b>All</b>					
World Total	50,694	48,019	53,972	40,747	193,432
Asia Total	12,264	11,614	12,151	6,528	42,557
East Asia Total	11,763	10,997	11,094	6,169	40,023
Asian NIEs	3,179	3,538	3,411	1,765	11,893
ASEAN 4	4,110	4,949	5,696	3,340	18,095
China	4,473	2,510	1,987	1,065	10,035
<b>Manufacturing</b>					
World Total	18,623	20,258	19,339	12,252	70,472
Asia Total	8,058	6,628	7,317	3,696	25,699
East Asia Total	7,762	6,193	6,681	3,444	24,080
Asian NIEs	1,186	1,235	1,872	633	4,926
ASEAN 4	3,096	3,155	3,296	2,009	11,556
China	3,480	1,804	1,513	802	7,599
<b>Non-Manufacturing</b>					
World Total	31,121	26,741	34,059	28,138	120,059
Asia Total	3,658	4,221	4,596	2,721	15,196
East Asia Total	3,500	4,086	4,245	2,631	14,462
Asian NIEs	1,774	1,796	1,503	1,116	6,189
ASEAN 4	837	1,625	2,294	1,270	6,026
China	890	665	447	245	2,247

Note: Asian NIEs refer to South Korea, Taiwan, Singapore and Hong Kong.

ASEAN 4 refer to Indonesia, Malaysia, Philippines and Thailand

Source: JETRO

By industry, large part of Japan's FDI in Asia, except for Asian NIEs, goes to the manufacturing sector. For the last four years, only 36% of Japan's total FDI have been in the manufacturing, while in Asia the manufacturing has accounted for 60% of FDI. In the fiscal year 1998, FDI much decreased in both the manufacturing and the non-manufacturing sectors, though the magnitude of decrease is even larger in the former.

(2) FDI from NIEs

South Korea is the largest investors among NIEs. Nearly half of FDI from South Korea goes to Asian countries in 1994-98 (Table 4.2). China is the most popular destination of South Korean FDI, accounting for almost half of the total value, followed by Hong Kong, Indonesia, Vietnam, and India. In 1998, 66% of South Korean FDI to Asia was for the manufacturing sector while the equivalent figure to the world total was 52%. Among the manufacturing FDI, Asia is preferred destination for food; leather and footwear; chemical; and non-metal mineral products, most of which are labor-intensive goods (Table 4.3). Korean outbound FDI is characterized with its concentration in Asia especially for labor intensive industries.

**Table 4.2 FDI from South Korea by Country (Approval)**

Unit: US\$ '000

	1994	1995	1996	1997	1998	1994-98
World Total	2,909,257	4,119,969	5,014,718	5,240,229	4,750,906	22,035,079
Asia Total	1,300,563	1,989,529	2,677,083	2,068,193	2,187,738	10,223,106
Japan	92,108	110,700	46,806	103,281	23,404	376,299
Singapore	1,556	25,750	68,556	57,911	290,974	444,747
Taiwan	3,002	2,493	7,387	4,518	18,700	36,100
Hongkong	93,223	97,027	94,437	242,676	451,368	978,731
Indonesia	-13,828	268,324	185,264	299,119	77,996	816,875
Thailand	16,186	24,798	63,989	223,025	103,756	431,754
Philippines	70,271	6,759	73,326	79,634	90,751	320,741
Malaysia	159,238	-26,251	17,497	57,651	23,282	231,417
India	52,294	177,326	364,500	4,669	74,446	673,235
Cambodia	2,000	500	895	17,717	1,777	22,889
China	724,290	1,072,569	1,414,116	792,429	802,914	4,806,318
Vietnam	117,036	200,351	192,488	110,396	87,504	707,775
Myanmar	-66,128	-3,839	4,219	11,665	3,468	-50,615
Laos	2,890	9,539	30,480	540	5,300	48,749

Source: Institute for International Trade and Investment (ITI)

**Table 4.3 FDI from South Korea by Industry  
(Approval, Accumulated at End 1998)**

Unit: US\$ '000

	Asia	Share (%)	World	Share (%)
Total	13,308,607	100.0	29,205,335	100.0
Mining	425,158	3.2	1,691,026	5.8
Forestry	36,400	0.3	137,096	0.5
Fishery	26,049	0.2	128,528	0.4
Manufacturing	8,752,164	65.8	15,295,079	52.4
Food	416,498	3.1	565,723	1.9
Textile & apparel	1,144,178	8.6	1,711,583	5.9
Leather & footwear	404,015	3.0	450,745	1.5
Wood & furniture	142,720	1.1	250,571	0.9
Paper & printing	213,700	1.6	277,561	1.0
Chemical	899,066	6.8	1,261,770	4.3
Non metal mineral	549,624	4.1	617,137	2.1
Basic metal	487,737	3.7	1,353,684	4.6
Metal semi-products	3,148,392	23.7	6,911,519	23.7
Machinery & eqpmt	536,051	4.0	699,191	2.4
Other manufacturing	810,184	6.1	1,195,600	4.1
Construction	512,308	3.8	728,732	2.5
Transportation	136,972	1.0	350,828	1.2
Trade	1,468,900	11.0	6,407,705	21.9
Other	1,950,655	14.7	4,466,340	15.3

Source: ITI, Japan

Taiwan is the second largest investors among NIEs. FDI from Taiwan, shown in Table 4.4 and 4.5, has similar characteristics to South Korea. In 1994-98, its FDI to Asia accounts for around 50% of the total FDI and as many as 60% of FDI to Asia fall into the manufacturing sector. Electric and electronic machinery has the largest share of Taiwan FDI to Asia, followed by food processing and chemical. Country-wise, China is by far the largest destination of FDI, though not classified as FDI, with 40% of the total FDI value invested there.

**Table 4.4 FDI from Taiwan by Country (Approval)**

Unit: US\$ '000

	1994	1995	1996	1997	1998	1994-98
World Total	1,616,764	1,356,878	2,165,404	2,863,826	3,296,302	11,299,174
Asia Total	559,471	467,743	661,717	818,743	580,819	3,088,493
Japan	22,731	8,811	6,798	32,342	29,596	100,278
South Korea	375	2,727	6,021	345	1,831	11,299
Singapore	100,732	31,649	164,978	230,310	158,176	685,845
Hongkong	127,284	99,555	59,927	141,593	68,643	497,002
Indonesia	20,571	32,067	82,612	55,861	19,541	210,652
Thailand	57,323	51,210	71,413	57,546	131,186	368,678
Philippines	9,600	35,724	74,252	127,022	38,777	285,375
Malaysia	101,127	67,302	93,534	85,088	19,736	366,787
Vietnam	108,378	108,146	100,479	85,414	110,078	512,495
Other Asia	11,350	30,552	1,703	3,222	3,255	50,082
China	962,200	1,092,700	1,229,200	1,614,500	2,034,600	6,933,200

Note: FDI to China not included in Total

Sources: Institute for International Trade and Investment (ITI), Japan, JETRO

**Table 4.5 FDI from Taiwan by Industry (Approval in 1998)**

Unit: US\$ '000

	Asia	Share (%)	World	Share (%)
Total	580,819	100.0	3,296,302	100.0
Agriculture & forestry	2,844	0.5	5,203	0.2
Mining	2,676	0.5	2,676	0.1
Manufacturing	355,025	61.1	1,036,884	31.5
Food	55,717	9.6	55,941	1.7
Textile	22,717	3.9	68,497	2.1
Apparel	11,480	2.0	20,294	0.6
Leather	460	0.1	460	0.0
Wood	2,884	0.5	107,285	3.3
Paper & printing	1,903	0.3	1,903	0.1
Chemical	50,850	8.8	89,209	2.7
Plastic	3,906	0.7	7,087	0.2
Non metal mineral	1,869	0.3	1,919	0.1
Basic metal	16,524	2.8	84,560	2.6
Machinery	16,818	2.9	18,377	0.6
Electric & electronics	164,175	28.3	515,112	15.6
Transport equipment	1,374	0.2	46,783	1.4
Precision machine	4,348	0.7	19,457	0.6
Construction	1,669	0.3	1,669	0.1
Wholesale and retail	24,188	4.2	116,343	3.5
Trade	17,762	3.1	173,848	5.3
Restaurant	140	0.0	140	0.0
Transport	24,453	4.2	58,333	1.8
Finance & insurance	132,315	22.8	1,788,760	54.3
Other services	19,747	3.4	110,679	3.4

Note: FDI to China not included in Total

Sources: ITI, Japan, JETRO

**(3) Singapore**

Around half of FDI amount from Singapore has been rendered to Asia from 1993 to 1997 (Table 4.6). For the last few years, FDI to China has significantly increased, while FDI to ASEAN countries has decreased sharply mainly because of the Asian economic crisis. Singapore's FDI is characterized with its heavy concentration in the financial sector. More than 60% of FDI in 1993-97 went to the financial sector whereas the manufacturing sector accounted for less than 20% of the total (Table 4.7). Further, Singapore banks have been active in purchasing banks in Asian region, such as in the Philippines, Thailand, and Hong Kong.

**Table 4.6 FDI from Singapore by Country**

Unit: Million Singapore \$

	1993	1994	1995	1996	1997	1993-97
World Total	4,440	7,584	9,380	3,079	11,290	35,773
Asia Total	2,434	5,715	6,266	433	3,935	18,783
ASEAN*	1,210	3,573	3,313	-553	810	8,353
Hongkong	796	1,093	474	-731	937	2,569
Taiwan	44	102	74	-47	60	233
China	369	881	1,549	2,001	1,694	6,494
Japan	20	75	224	-38	149	430
Other Asia	-77	-65	400	159	285	702

Note: In this table ASEAN refers to Brunei, Indonesia, Malaysia, Philippines, Thailand and Vietnam

Source: Singapore Department of Statistics 'Yearbook of Statistics Singapore 2000'

**Table 4.7 FDI from Singapore by Industry**

Unit: Million Singapore \$

	1993	1994	1995	1996	1997	1993-97
Total	4,440	7,584	9,380	3,079	11,290	35,773
Manufacturing	790	2,492	3,176	-1,186	928	6,200
Construction	57	49	175	-109	-24	148
Commerce	318	515	977	-175	207	1,842
Transport & storage	256	347	320	-27	731	1,627
Financial	2,472	3,248	4,139	4,603	8,097	22,559
Real estate	457	569	671	319	489	2,505
Business services	171	239	-100	-367	881	824
Others	-81	127	20	22	-21	67

Note: In this table ASEAN refers to Brunei, Indonesia, Malaysia, Philippines, Thailand and Vietnam

Source: Singapore Department of Statistics 'Yearbook of Statistics Singapore 2000'

## 4.2 Results of Investment Demand Survey

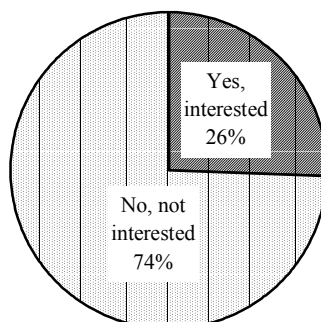
Investment demand survey through questionnaires and interviews, meant to seek the future possibility of investment in Savannakhet, was conducted in Thailand and Vietnam in the course of the Study. In addition, the data collected in the past survey of Lao industries was analyzed to complement the surveys in Thailand and Vietnam. Summary of the survey results is presented below, while the detailed results are presented in Appendix 1.

### (1) Thailand

Of 78 respondents to the questionnaire survey, 20 enterprises showed interests in SEZ development in Savannakhet. Those enterprises are classified by subsector into:

**Table 4.8 Interest Shown in Savannakhet SEZ**

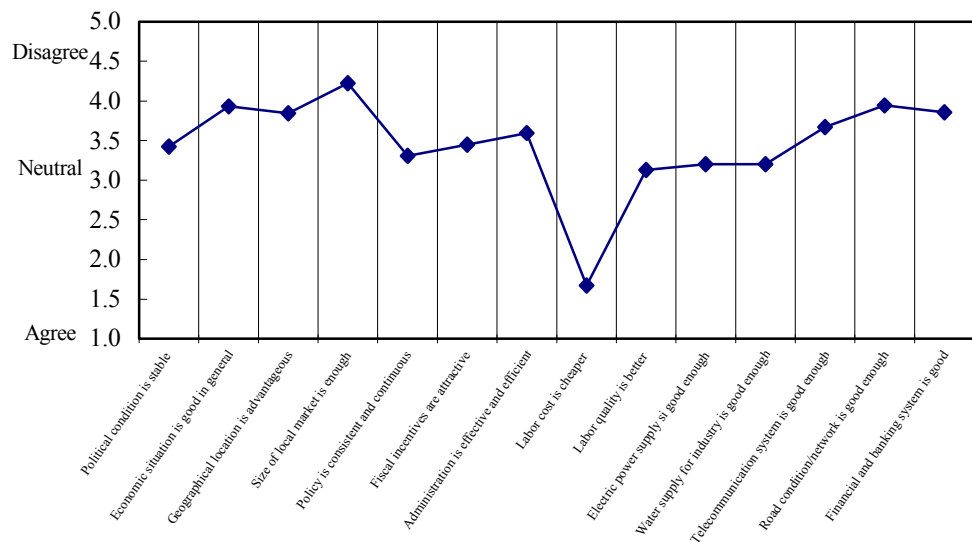
Subsector	Nos. of Enterprises
Agriculture & marine product	1
Chemicals	1
Textile & Garment	4
Machinery	7
Transportation	5
Electric & Electronics	2



**Figure 4.3 Interested in Savannakhet SEZ  
- Thai Enterprises n=78**

Most respondents, including those interested in Lao PDR, evaluate the Lao investment environment as less favorable. Especially, they see economic infrastructure such as telecommunications and road conditions are of low grade. One and only advantageous factor, which Lao PDR has in terms of investment attraction, is low cost of labor.

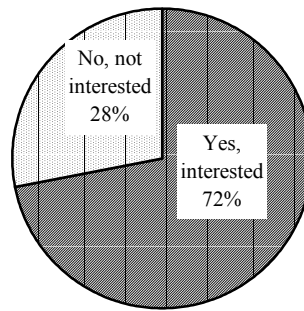
The interview survey revealed that even the companies, which gave positive responses in the questionnaire survey, had limited knowledge of Lao PDR. Some potential investors suggested that Lao PDR should utilize, in promoting investment, local resources such as agricultural and forestry products, mineral resources and low cost labor.



**Figure 4.4 Evaluation of Lao Investment Environment by Thai Enterprises**

(2) Vietnam

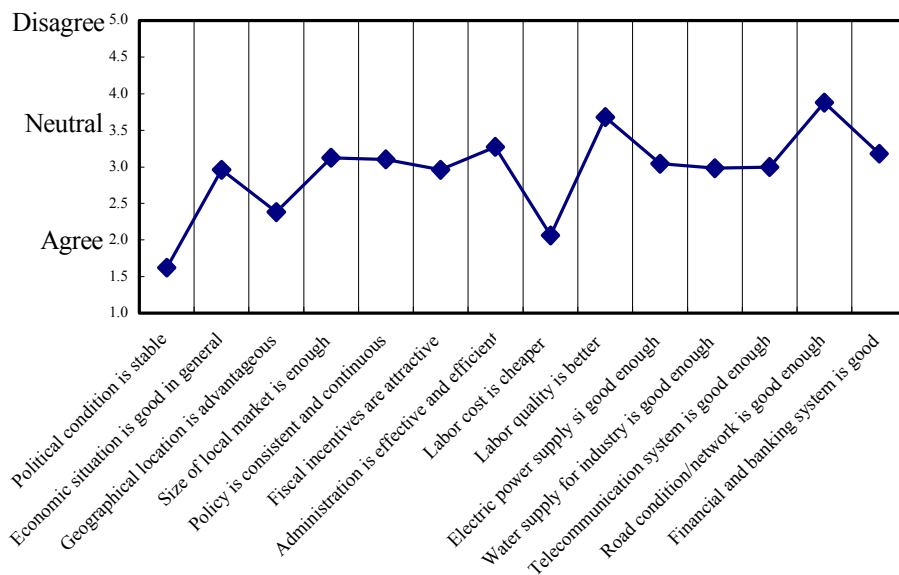
Of 50 surveyed companies in Da Nang, 36 enterprises or 72% gave positive responses, showing interests, more or less, in SEZ development in Savannakhet. Many of them showed their plan of setting up factories in SEZ by giving specific features of the factory such as main products, area, number of employees, etc.



**Figure 4.5 Interested in Savannakhet SEZ  
- Vietnamese Enterprises n=50**

As for general evaluation of the investment climate of Lao PDR, they gave generous, though not high, ratings on various factors, if compared to Thai enterprises' ratings. However, it is found through an interview by the Study Team that their intention to set up factories in Lao PDR is not so serious. Vietnamese enterprises generally assess the Lao investment environment not so attractive.

Especially, it appears that Vietnamese investors prefer using Vietnamese workers if they are to make an investment in Lao PDR because their evaluation of Lao workers is relatively low.



**Figure 4.6 Evaluation of Lao Investment Environment by Vietnamese Enterprises**

In addition, it appears that FDI in the Savannakhet area will not drastically increase even after 2004 when improvements of Route 9, Route 1 (Vietnam) and Da Nang seaport are envisaged. Reasons are:

- (i) It may take around eight hours from Savannakhet to Da Nang port even with the completion of Hai Van Pass tunnel in Route 1 and improvements of Route 9, with an implication that the time required is almost the same as to access from Savannakhet to Laem Chabang port in Thailand and;
- (ii) Da Nang port is known at present as to impose much more expensive port charges compared with other Vietnamese and Thai ports.

(3) Lao Enterprises

Out of 191 surveyed enterprises, 79 enterprises or 41% list "financial support for export" as the desired governmental support program to the private sector. "Foreign market information services" (30%), "training service for business administration" (24%) and "expansion of bank financing" (22%) are other programs they most require. It is clear that they are eager to seek export market.

Enterprises located in Savannakhet, 28 in total, show a similar tendency, wanting "financial support for export" and "foreign market information services". In addition, "deregulation in plant and equipment investment" is also desired.

Joint venture between Lao and foreign enterprises, 37 in total, too, show generally similar results, though they take more "training service for technology development" and "improvement of laws and regulation" as desired support programs.

### **4.3 Target Subsectors**

(1) Implications of Demand Analysis

A number of problems have been identified through investment demand analysis and examination of the investment environment of Lao PDR. They are:

- Potential investors' knowledge on Lao PDR is rather limited;
- Infrastructure such as road, power and telecommunications is yet insufficient;
- Human resources are insufficient, quantitatively and qualitatively;
- General investment environment, including economic condition is less favorable;

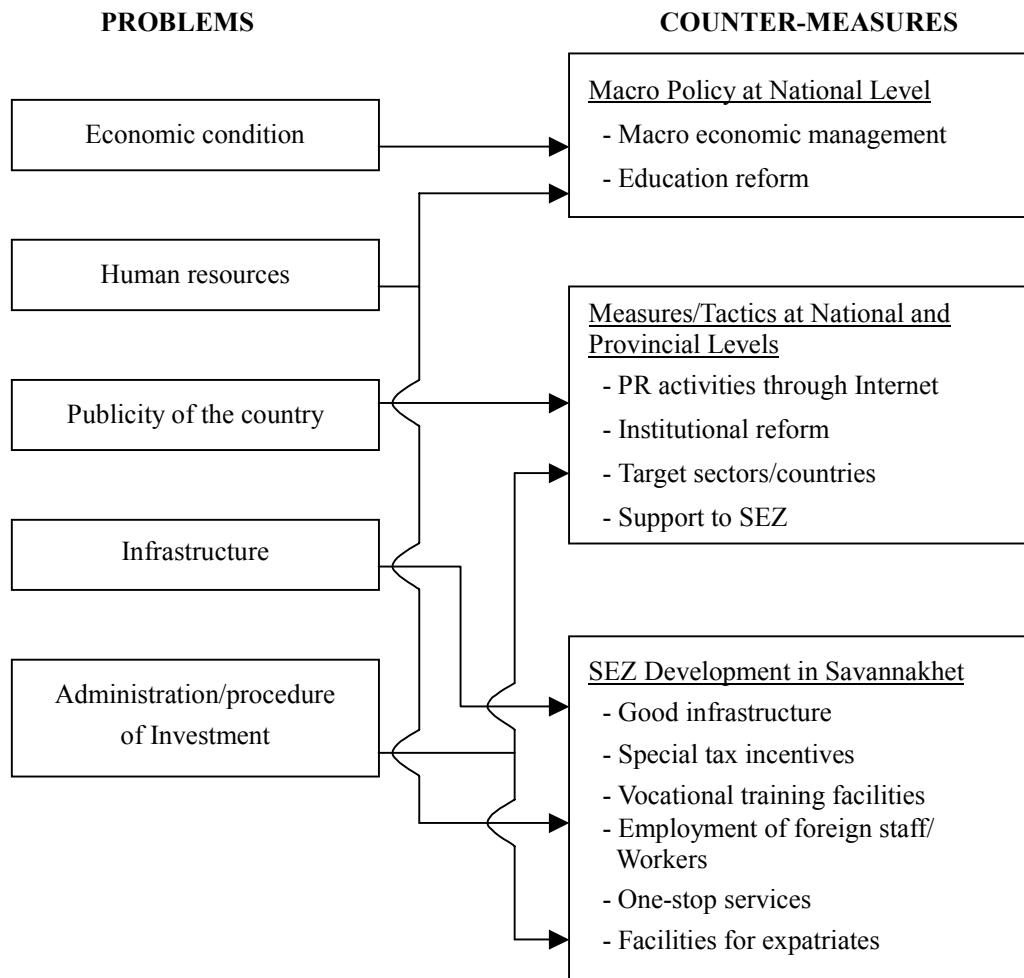


- Promotional activities and institutional setting for investment promotion are yet insufficient.

To tackle these problems in promoting development of SEZ in Savannakhet, strategic FDI promotion is required including the following measures:

- Strategic public information activities on Lao PDR in general and the investment environment procedures, through Internet and diplomatic missions abroad by making full use of the planned “East-West Economic Corridor”;
- Strategic promotional activities, targeting specific industrial sectors and specific regions/countries;
- Upgrading or re-organizing investment promotional institution for more effective FDI attraction;
- Efforts to improve macroeconomic stability;
- Efforts to promote human resources development, including education and training;
- Good infrastructure and training facilities in SEZ (for budgetary reason, small-scale development is recommended);
- Generous fiscal incentives and for SEZ, e.g. duty free and tax holiday;
- One-stop services for investors;
- Special treatment for employment in SEZ and good living conditions for expatriates.

Major problems and possible counter-measures to those problems are summarized in Figure 4.7. It should be kept in mind that in order to attract FDI into the SEZ, fundamental economic policy and FDI promotional activities at national and provincial levels are as essential as the development of and special incentives for the SEZ itself.



**Figure 4.7 Investment Promotion Strategy**

(2) Assessment of Target Subsectors

Recent trends of FDI flow from Asian countries, especially from South Korea and Taiwan, show that more advanced Asian neighbors look for production bases for labor intensive industries within the region, as they are losing competitiveness in these industries.

It is clear from the results of investment demand survey that Lao PDR is in a rather difficult position to attract foreign investment, as not many enterprises in Thailand and Vietnam consider Lao PDR as a target for investment. Nonetheless, it is suggested that those industries, which do not require huge amount of investment, but utilize local resources of Savannakhet, existing or potential, are prospective.

It appears that Savannakhet has comparative advantage, at present or in the future, for such industries as resource-based industries, light manufacturing

and assembling. In addition, it is expected that in the wake of completion of the new Mekong Bridge between Savannakhet and Mukdahan and improvement of Route 9, increasing demand for transport related business and tourism facilities would prevail.

Considering these factors, the following subsectors appear to have a good potential for investment and set as targets for promotion in the Savannakhet area:

- 1) Wood processing, including furniture
- 2) Agro-based industry, including food processing
- 3) Garment
- 4) Electric/electronic assembling
- 5) Packaging and labeling
- 6) Transport-related logistic industry
- 7) Tourism and service industry

In addition, specific regions or countries should be targeted in promoting FDI into the SEZ and promotional activities should be intensively extended mainly in those targeted countries. It is most likely that main investors in the Savannakhet SEZ are from East and South-East Asian countries. Particularly the two proximate neighbors, Thailand and Vietnam, may be prominent investors in the SEZ.

### (3) Current Situation of Target Subsectors in Neighboring Countries

It is significant to look at current situation of target subsectors mentioned above, in the neighboring countries. A few selected target subsectors/products are described below depending on data availability<sup>1</sup>.

#### 1) Wooden furniture in Thailand

Wood furniture is mainly manufactured for exports which account for 70% of the total export value of furniture. Japan and the US remain Thailand's main export markets. There are approximately 2,898 wood furniture manufacturers, mostly being medium and small enterprises. The manufacturers with export capacity tend to be those of medium or large sized ones. In addition, the channels of distribution may be through direct sales, from the manufacturing plants to target customers, or through dealers which are furniture stores, medium and large department stores and through

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<sup>1</sup> Parts of information described here were cited from 'Industry Sector Analysis Reports' by BAEF & LAACC (<http://www.tradeport.org/ts/partners/index.html>).

furniture exhibitions. Hardwood is mainly imported from abroad, whereas rubber wood is purchased in Thailand. To produce wood furniture with capacity of 10,000 units per year with 8 working hours daily requires an initial investment of about Baht 18 million<sup>2</sup>.

## 2) Food processing in Thailand

The market of food processing was estimated at US\$654.9 million in 1997 of which approximately US\$516.7 million were imported. It is estimated that the market for the industry, combined with that for packaging equipment, packaging will grow by 7% in the next few years due to the recovery of the local economy, and the Thai government's master plan to develop and increase value added in the food processing sector. In 1997, there were more than 50,000 large, medium, and small food processing and packaging plants registered with the government. Large firms account for the greatest production capacity and demand for imported food processing and packaging equipment.

## 3) Food processing in Vietnam

Vietnam is focused on bolstering the efficiency of the food processing sector by increasing the added value of final food products. This has required that the country invest more in food processing factories either by upgrading the existing plants or by building new ones. Thus, the market for food processing and packaging equipment has been gradually growing for the past several years. It is estimated that the market for food processing and packaging equipment in Vietnam will be US\$250 million, of which local production accounts for US\$90, in 1998 and will continue its steady growth at an annual rate of 30% for the next few years.

## 4) Textile and garment in Thailand

Textile and garment industry has a major contribution to the economy as a whole in terms of GDP, employment, and exports. In 1996, prior to the crisis, GDP in textile subsector accounted for about 15% of GDP in manufacturing or 4.7% of GDP in total. In addition, with around 1.1 million workers, it has the highest employment share in manufacturing, that is, over 25% of workers employed in manufacturing are engaged in textile and garment production. Textile and garment have also been the country's major foreign exchange earners since 1985. In 1995, the export of textile and garment reached US\$6.5 billion, accounting for 11.6% of total exports. The Thai textile and

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<sup>2</sup> 1\$=43.5 baht as of 5 December 2000. 18 million Baht  $\doteq$  \$413.793

garment sector is characterized by a large number of firms in the labor intensive garment and weaving industry and a smaller number of firms in capital intensive spinning and man-made fiber production, and dying and finishing firms. The garment makes the highest contribution to the country's value-added, export earnings and employment in the manufacturing sector. According to statistics, there were 2,856 garment mills. These firms employed more than 850,000 people, accounting for 20% of employment in manufacturing industry. The industry is now responding to the battering of the region's economic recession and the rise of cheaper competition by integrating its upstream and downstream activities.

#### 5) Textile and garment in Vietnam

In Vietnam, textiles and garments are considered part of a single industry. It is an important industry, because it is labor-intensive, employing workers who do not require extensive training, and it has contributed considerably to the export revenue of Vietnam in recent years. Vietnamese firms import a huge amount of textile products. In 1997, 23 countries exported textile products to Vietnam. The biggest players are Taiwan, South Korea, and Japan. Textile products made by Vietnamese companies occupy a small part of the total Vietnamese demand. End users of textile products in Vietnam are garment companies and tailors. There are 130 State-owned garment companies, 394 non-State-owned enterprises and collectives, 88 foreign investment companies, and some 30,000 tailors. State-owned firms have the largest capacity in the garment industry. By joining ASEAN (July, 1995), signing the trading agreement with EU (July, 1996), joining CEPT (1996) and preparing to join APEC and WTO, the future of the Vietnamese textile industry looks very promising. The industry has plans to develop its capacity and will produce one billion meters of cloth of various types by the year 2005.

#### 6) Electronics in Thailand

In Thailand, the electronics industry has played a significant role in the economy during the past two decades. Employing more than 300,000 people within the industry, most electronic products are manufactured by multinational corporations for global markets. With total industry real growth rates estimated at 10% in 1999, far exceeding that of Thailand's GDP as well as the entire manufacturing sector, the electronics sector has become an increasingly important contributor to the Thai economy in terms of production, exports, and employment. In 1997, total exports of electronic

products amounted to Baht 458.4 billion (US\$12.4 billion), representing around 27% of total exports from Thailand. During the same year, 12 of the multinational corporations who have established facilities in Thailand registered export sales of more than Baht 10 billion (US\$270 million). The electronics industry exports for 1998, despite the economic crisis in Thailand, registered an impressive Baht 791 billion (US\$ 1.4 billion) in export sales representing 35% of Thailand's total exports. In overall global production, the electronics and electrical industries have registered consistent growth with combined values increasing from US\$463 billion in 1986 to US\$ 850 billion in 1996, and it is estimated to increase to US\$1.24 trillion and US\$2.2 trillion in years 2001 and 2010, respectively. Thailand is likely to be a world competitor in the electronics industry in the near future.

(4) Prospective Subsectors in Savannakhet

Judging from observations on the status of the target subsectors in Thailand and Vietnam, though information is limited, those subsectors appear to be prospective in the Savannakhet SEZ for the following reasons:

- Wood processing, especially furniture manufacturing, could attract investment from Thailand where domestic and export markets and production technology are somehow established, because of abundant resource availability in Lao PDR.
- Food processing is rapidly growing in both Thailand and Vietnam. Lao PDR, with an advantage of proximity to them and lower labor cost, will have a good chance to penetrate those growing markets by processing foods with local and foreign investment.
- Textile and garment are huge industry in Thailand and in Vietnam. They mainly seek world markets and are faced with fierce competition. It is likely that they locate production base in the SEZ, especially for lower-market oriented production, if provided low cost labor and reasonable infrastructure.
- Electronics, now a major export earner of Thailand, is also promising in Lao PDR in the future. The Lao manufacturers can have a role to support Thai investors, by assembling the products with lower cost.